DOCUMENT RESUME

ED 295 766 RC 016 604

TITLE	New Perspectives on the Rural Economy. Hearing on New Perspectives on the Rural Economy before the Subcommittee on Rural Economy and Family Farming of the Committee on Small Business. United States Senate, One Hundredth Congress, First Session.
INSTITUTION	Congress of the U.S., Washington, DC. Senate Committee on Small Business.
REPORT NO	Senate-Hrg-100-40
PUB DATE	5 Mar 87
NOTE	194p.; Some pages contain small, light type.
AVAILABLE FROM	Superintendent of Documents, Congressional Sales Office, U.S. Government Printing Office, Washington, DC 20402.
PUB TYPE	Legal/Legislative/Regulatory Materials (090)
EDRS PRICE	MF01/PC08 Plus Postage.
DESCRIPTORS	*Economic Change; *Economic Climate; Employment; Futures (of Society); Hearings; Job Development; *Policy Formation; *Rural Development; *Rural Economics; *Small Businesses
IDENTIFIERS	Congress 100th; Economic Planning; *Economic Trends

ABSTRACT

Testimony and prepared statements presented at a hearing before the Senate Subcommittee on Rural Economy and Family Farming focused on the concerns of rural small business. Witnesses included Senators from Montana, Illinois, New York, Oklahoma, South Dakota, Wisconsin, Minnesota, and Iowa, and nine representatives of business, state government, federal agencies, education, and regional development agencies. Witnesses presented economic facts which described rural America as accounting for 25% of the nation's population, only 20% of United States personal income, more than 40% of the country's elderly, 38% of the nation's poor, 67% of all substandard housing, and unemployment exceeding twice the national average. Witnesses suggested that to revitalize rural America, new jobs in both traditional and new industries are needed. Others indicated that the rural economy no longer means isolated and sparsely populated farm communities, but a collection of many diverse economies, depending not only on traditional farming, fishing, timber, and mining industries, but also new industries like manufacturing, services, and tourism. (NEC)

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NEW PERSPECTIVES ON THE RURAL ECONOMY

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HEARING

BEFORE THE

SUBCOMMITTEE ON RURAL ECONOMY AND FAMILY FARMING

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

NEW PERSPECTIVES ON THE RURAL ECONOMY

MARCH 5, 1987

U.S. DEPARTMENT OF EDUCATION
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U.S. GOVERNMENT PRINTING OFFICE
72-337 WASHINGTON : 1987

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NEW PERSPECTIVES ON THE RURAL ECONOMY

THURSDAY, MARCH 5, 1987

U.S. SENATE,
SUBCOMMITTEE ON RURAL ECONOMY AND FAMILY FARMING, OF THE COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 9:34 a.m., in room SR-428A, Russell Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator BAUCUS. The Subcommittee on the Rural Economy and Family Farming will come to order.

I am pleased to convene this Subcommittee, the Rural Economy and Family Farming Subcommittee. I first want to thank Senator Bumpers, Chairman of the Committee, for setting up this subcommittee because it is extremely important that we focus on the problems facing rural America, and particularly small business in rural America.

This is the first subcommittee to focus exclusively on the concerns of rural small business. Our work will be based on one bedrock premise: The rural economy is changing, and unless we adapt it will continue to change for the worse.

We are becoming a Nation with two economies: a glittering urban economy on the Coast and the Sunbelt, and a declining rural economy in between. An article in Monday's New York Times put it bluntly, and I quote:

> Not only are many rural areas losing population, but more of the people who live there are out of work living in poverty. The widening gap is evident regardless on whether a country is dependent on agriculture, manufacturing, forestry, or mining, trade, or anything else except service to retirement communities.

We should not tolerate this division of prosperity. As FDR said, our economy cannot endure "if it is half boom and half bust. "So how do we turn this around? We have to start by understanding what is happening. This means understanding that the rural economy is much more than an agricultural economy. The family farm remains the economic foundation of rural America, but more and more farmers must supplement their income with a job in town just to survive.

The proportion of total family farm income earned from off-farm sources has increased from an average of about 40 percent in 1960 to 72 percent in 1983. Ironically, the viability of the family farm may depend on the availability of a nonfarm job in town.

Where do those jobs come from? Small towns in rural America have traditionally been built around natural resource industries like timber, mining, and fishing; but as natural resources become decoupled from industry, rural communities become decoupled from the mainstream of economic growth. As a result, the gap between urban and rural personal income is widening. Thirty-eight percent of the Nation's poor, and 67 percent of all substandard housing are in rural areas, and about 90 percent of all counties with extremely high unemployment rates are rural.

To revitalize rural America we need not only new jobs in traditional industries, but new industries, as well. In Maine, this means rebuilding the salmon fisheries that disappeared from decades of overfishing. In Montana, it means adopting foreign technology for processing softwood into quality flooring, furniture, and building materials.

In Minnesota, it means manufacturing chopsticks for export to the Japanese. This subcommittee can help us understand the rural economy. We must dispel the notion that the rural economy means isolated and sparsely populated farm communities. The rural economy really means a collection of many diverse economies, depending not only on traditional farming, fishing, timber, and mining industries, but also new industries like manufacturing, services, and tourism.

Understanding this, we must develop policies that will make the economic transition clearer and promote the growth of new industries. Today's hearing is a first step.

Later on, this subcommittee will hold additional hearings on specific ways to improve rural economies. One way is to help small rural industries adopt new technology and assure that Federal research development efforts adequately reflect rural needs.

Another way is to improve capital formation in rural areas. Capital formation remains a major impediment to rural business startups and to expansion. Federal resources such as the SBA guaranteed loan program, small business investment companies, and others provide critical assistance. I intend to have the subcommittee investigate their roles and explore possible expansion.

I also expect the subcommittee to review the effects of other Federal policies such as the deregulation of transportation, of communications, and of banking. Today's hearing gets us off to a running start. We are privileged to hear from a group of nationally known experts on rural economic development.

I know many of the witnesses have their own ideas and proposals, and I look forward to exploring them this morning.

[The prepared statement of Senator Baucus follows:]

STATEMENT

BY

SENATOR MAX BAUCUS

"New Perspectives on the Rural Economy"

Hearing Before the Subcommittee on the Rural
Economy and Family Farm
Senate Committee on Small Business
March 5, 1987

Introduction

I am pleased to convene the first hearing of the Rural Economy and Family Farm Subcommittee.

First of all, I want to thank our Committee Chairman, Senator Bumpers, for agreeing to establish this subcommittee. I know that he shares my interest in rural economic development, and I look forward to working with him..

THIS IS THE FIRST SUBCOMMITTEE TO FOCUS EXCLUSIVELY ON THE CONCERNS OF RURAL SMALL BUSINESSES.

OUR WORK WILL BE BASED ON ONE BEDROCK PREMISE: THE RURAL ECONOMY IS CHANGING. AND UNLESS WE ADAPT, IT WILL CONTINUE TO CHANGE FOR THE WORSE.

Two Economies

WE ARE BECOMING A NATION WITH TWO ECONOMIES: A GLITTERING URBAN ECONOMY ON THE COAST AND A DECLINING RURAL ECONOMY IN BETWEEN. AN ARTICLE IN MONDAY'S New York Times PUT IT BLUNTLY:

> "NOT ONLY ARE MANY RURAL AREAS LOSING POPULATION, BUT MORE OF THE PEOPLE WHO LIVE THERE ARE OUT OF WORK, LIVING IN POVERTY. AND THE WIDENING GAP IS EVIDENT REGARDLESS OF WHETHER A COUNTY IS DEPENDENT ON AGRICULTURE OR MANUFACTURING, FORESTRY OR MINING, TRADE OR ALMOST ANYTHING ELSE EXCEPT SERVICE TO RETIREMENT COMMUNITIES."

WE SHOULD NOT TOLERATE THIS DIVISION OF PROSPERITY. AS FDR SAID, OUR ECONOMY CANNOT ENDURE "IF IT IS HALF BOOM AND HALF BUST."

ADAPTING TO CHANGE

SO HOW DO WE TURN THINGS AROUND?

WE HAVE TO START BY UNDERSTANDING EXACTLY WHAT'S GOING ON.

THIS MEANS UNDERSTANDING THAT THE RURAL ECONOMY IS MUCH MORE THAN AN AGRICULTURAL ECONOMY.

THE FAMILY FARM REMAINS THE ECONOMIC FOUNDATION OF RURAL AMERICA. BUT MORE AND MORE FARMERS MUST SUPPLEMENT THEIR INCOME WITH A JOB IN TOWN JUST TO SURVIVE. THE PROPORTION OF TOTAL FAMILY FARM INCOME EARNED FROM OFF-FARM SOURCES HAS INCREASED FROM AN AVERAGE OF ABOUT 40 PERCENT IN 1960 TO OVER 72% IN 1983.

IRONICALLY, THE VIABILITY OF THE FAMILY FARM MAY DEPEND ON THE AVAILABILITY OF A NON-FARM JOB IN TOWN.

BUT WHERE WILL THOSE JOBS COME FROM?

SMALL TOWNS IN RURAL AMERICA HAVE TRADITIONALLY BEEN BUILT AROUND NATURAL RESOURCE INDUSTRIES LIKE TIMBER, MINING, AND FISHING.

BUT AS NATURAL RESOURCES HAVE BECOME "DECOUPLED" FROM INDUSTRY, RURAL COMMUNITIES BECOME "DECOUPLED" FROM THE MAINSTREAM OF ECONOMIC GROWTH. AS A RESULT:

- THE GAP BETWEEN URBAN AND RURAL PERSONAL INCOME IS WIDENING.
- THIRTY-EIGHT PERCENT OF THE NATION'S POOR AND AN SIXTY-SEVEN PERCENT OF ALL SUBSTANDARD HOUSING ARE IN RURAL AREAS.
- AND ABOUT NINETY PERCENT OF ALL COUNTIES WITH EXTREMELY HIGH UNEMPLOYMENT RATES ARE RURAL.

Fighting Back

To revitalize rural America, we need not only new jobs in the traditional industries, but new industries as well.

In Maine, this means rebuilding a salmon fishery that disappeared from decades of over-fishing.

In Montana, it means adopting foreign technology for processing soft-wood into quality flooring, furniture and building materials.

In Minnesota, it means manufacturing chop sticks for export to the Japanese.

The Subcommittee Agenda

This subcommittee can help us understand the rural economy.

WE MUST DISPEL THE NOTION THAT "THE RURAL ECONOMY" MEANS ISOLATED AND SPARSELY POPULATED FARM COMMUNITIES.

THE RURAL ECONOMY REALLY MEANS A COLLECTION OF MANY DIVERSE ECONOMIES, DEPENDING NOT ONLY ON THE TRADITIONAL FARMING, MINING, TIMBER AND FISHING INDUSTRIES BUT NOW ALSO ON NEW INDUSTRIES LIKE MANUFACTURING, SERVICES AND TOURISM.

UNDERSTANDING THIS, WE THEN MUST DEVELOP POLICIES THAT WILL MAKE ECONOMIC TRANSITION EASIER AND PROMOTE THE GROWTH OF NEW INDUSTRIES.

TODAY'S HEARING IS A FIRST STEP, TO BEGIN A GENERAL DIALOGUE.

NEXT, THE SUBCOMMITTEE WILL HOLD ADDITIONAL HEARINGS ON SPECIFIC WAYS TO IMPROVE THE RURAL ECONOMY.

ONE WAY IS TO HELP SMALL RURAL INDUSTRIES ADOPT NEW TECHNOLOGY AND ASSURE THAT FEDERAL RESEARCH AND DEVELOPMENT EFFORTS ADEQUATELY REFLECT RURAL NEEDS.

ANOTHER WAY IS TO IMPROVE CAPITAL FORMATION IN RURAL AREAS. THIS REMAINS A MAJOR IMPEDIMENT TO RURAL BUSINESS STARTUPS AND EXPANSION. FEDERAL RESOURCES, SUCH AS THE SBA GUARANTEED LOAN PROGRAM, SMALL BUSINESS INVESTMENT COMPANIES AND OTHERS CAN PROVIDE CRITICAL ASSISTANCE. I EXPECT TO HAVE THE SUBCOMMITTEE INVESTIGATE THEIR ROLE AND EXPLORE POSSIBLE EXPANSION.

I ALSO EXPECT THE SUBCOMMITTEE TO REVIEW THE EFFECTS OF OTHER FEDERAL POLICIES, SUCH AS DEREGULATION OF TRANSPORTATION, COMMUNICATIONS AND BANKING.

TODAY'S HEARING

TODAY'S HEARING GETS US OFF TO A RUNNING START. WE ARE PRIVILEGED TO HEAR FROM A GROUP OF NATIONALLY KNOW EXPERTS ON RURAL ECONOMIC DEVELOPMENT.

I KNOW THAT MANY OF THE WITNESSES HAVE THEIR OWN IDEAS AND PROPOSALS. I LOOK FORWARD TO EXPLORING THEM THIS MORNING.

WE HAVE AN ESPECIALLY LONG AGENDA, AND A NUMBER OF SENATORS PLAN TO ATTEND AND ASK QUESTIONS. I ASK EACH OF YOU TO SUMMARIZE YOUR WRITTEN STATEMENTS IN ABOUT FIVE MINUTES. THAT WAY, WE WILL HAVE PLENTY OF TIME FOR QUESTIONS.

Senator BAUCUS. At this point want to turn to my good friend, the Senator from Illinois, Senator Dixon. Senator, do you have a statement you would like to make this morning?

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Mr. Chairman, I have already placed a statement in the record, subject to your approval, and I congratulate you upon holding these hearings, and am delighted to have an opportunity to attend them with you.

Senator BAUCUS. Without objection, the statement will be included.

[The prepared statements of Senators Dixon and D'Amato follow:]

MARCH 5, 1987

STATEMENT BY SENATOR ALAN J. DIXON

COMMITTEE ON SMALL BUSINESS

NEW PERSPECTIVES ON THE RURAL ECONOMY

MR. CHAIRMAN, THE MAKE-UP OF OUR RURAL ECONOMY IS CHANGING BUT OUR RESPONSIBILITY TO THE RURAL COMMUNITY IS NOT. WE STILL MUST MAKE PROVISIONS FOR JOBS AND PROMOTE THE ECONOMIC WELL BEING OF THIS SECTOR OF OUR ECONOMY.

WE MUST BE AWARE THAT THE EVOLUTION OF THE RURAL ECONOMY IS INTERWOVEN INTO AREAS BEYOND AGRICULTURE. ANY POLICY THAT WE CONSIDER MUST ADDRESS THE NEEDS OF THE ENTIRE RURAL COMMUNITY. MOST OF US ARE AWARE OF THE FARM DEPENDENT LOCALITIES WHICH ARE LOSING POPULATION AND ARE BEING AFFECTED BY FOREIGN TRADE AND FISCAL POLICIES. BUT THERE ARE MANUFACTURING/PROCESSING DEPENDENT RURAL AREAS WHICH HAVE A LARGE NUMBER OF SINGLE SKILLED AND MINORITY WORKERS. THERE ARE GOVERNMENT DEPENDENT RETIREMENT AND POVERTY STRIKEN RURAL AREAS THAT MUST ALSO BE CONSIDERED. EACH OF THESE SEGMENTS IS AFFECTED DIFFERENTLY BY THE POLICIES THAT WE ENACT.

THE DEPRECIATION OF FARM VALUES DUE TO HIGH REAL ESTATE INTEREST AND LOW COMMODITY PRICES IN THE '80s IMPACTS THESE OTHER AREAS OF THE RURAL ECOMOMY. AS THE FARMERS' INCOME IS

REDUCED THOSE THAT SUPPLY THE FARM NEEDS AND THOSE FROM WHOM THE FARMER PURCHASES COMSUMER AND RETAIL FOODS SUFFER.

HOWEVER, ACCORDING TO AN ARTICLE IN THE ECONOMIC REVIEW, ENTITLED "A CHANGING RURAL AMERICA", "THE FARM FINANCIAL STRESS IS THE MOST WIDELY KNOWN REASON FOR RURAL ECONOMIC PROBLEMS...(IT IS) LEAVING A TRAIL OF SERIOUS MARKS ON THE RURAL ECONOMY ...".

AGRICLTURE IS DOMINATED BY THE LARGE AND SMALL PART-TIME FARMERS. BUT MOST RURAL COMMUNITIES ARE BUILT AROUND THE AVERAGE FAMILY FARMER. AGAIN, ACCORDING TO THE ECONOMIC REVIEW ARTICLE, IN 1984, 70% OF THE FARMS IN THE UNITED STATES HAD SALES OF UNDER $40,000-EARNING MORE INCOME OFF THE FARM THAN ON IT. THIS GROUP PRODUCED ONLY 15% OF OUR FARM PRODUCTS. BY CONTRAST, 30% OF THE FARM PRODUCTS WERE PRODUCED BY 1% OF THE FARMS WITH SALES OVER $500,000 PER FARM ANNUALLY.

IN ILLINOIS THE STATISTICS DIFFER SLIGHTLY: 54% OF THE FARMS HAVE SALES OF LESS THAN $40,000; WHAT IS REFERRRED TO AS THE AVERAGE FAMILY FARMER COMPRISES 45% OF FARM SALES IN ILLINOIS; AND AS WITH THE NATIONAL AVERAGE, ONLY 1% OF OUR FARMS HAVE SALES OVER $500,000.

INDIVIDUALS AND FAMILIES ARE NOT JUST LOSING THEIR JOBS, THEY ARE LOSING A WAY OF LIFE AND THOSE INDUSTRIES AND INDIVIDUALS DEPENDENT UPON FAMILY FARMERS ARE LOSING ALSO. IT IS A NEGATIVE SPIRAL. IT BEHOOVES THIS CONGRESS TO EASE THE TRANSITION IN THIS EVOLUTION IN RURAL ECONOMY TO PROMOTE

ECONOMIC WELL BEING--NOT JUST THROUGH THE FOOD SECURITY ACT BUT BY PROVIDING KNOWLEDGE OF AND ACCESS TO EXISTING PROGRAMS IN OTHER AGENCIES SUCH AS THE SMALL BUSINESS ADMINISTRATION AND COMMERCE DEPARTMENT TO HELP RURAL AMERICANS BECOME ENTREPREUNUERS, FIND JOBS, AND ENTER THE EVER GROWING SERVICE INDUSTRIES.

STATEMENT BY SENATOR ALFONSE M. D'AMATO

SENATE COMMITTEE ON SMALL BUSINESS

MARCH 5, 1987

MR. CHAIRMAN, I WELCOME OUR DISTINGUISHED PANEL OF WITNESSES TO THE SMALL BUSINESS COMMITTEE THIS MORNING TO SHARE WITH US THEIR VIEWS REGARDING NEW PERSPECTIVES ON THE RURAL ECONOMY. I ESPECIALLY WANT TO WELCOME NEW YORK STATE SENATOR CHARLES D. COOK WHO SERVES AS CHAIRMAN OF THE LEGISLATIVE COMMISSION ON THE DEVELOPMENT OF RURAL RESOURCES.

TOO OFTEN MANY OF US EQUATE "RURAL" WITH "AGRICULTURAL" AREAS. PERHAPS AT ONE TIME THIS WAS CORRECT. HOWEVER, TODAY THERE IS A DRAMATIC CHANGE IN RURAL DEMOGRAPHY. REPLACING ACRES OF FARMLAND ARE NEW OFFICE BUILDINGS PROVIDING LOW-COST OFFICE SPACE FOR THE URBAN CORPORATE CENTER'S BACK-OFFICE OPERATIONS. REPLACING THE FARMHOUSE ARE RUSTIC BED AND BREAKFASTS PROVIDING A COUNTRYSIDE ESCAPE FROM THE BIG CITY. IN GROWING PROPORTIONS RETIREMENT-AGE PERSONS ARE SEEKING THE TRANQUILTY OF RURAL AREAS FOR A MORE PEACEFUL EXISTENCE.

HOWEVER, THESE CHANGES HAVE CAUSED SERIOUS PROBLEMS. FOREMOST AMONG THESE IS THE ECONOMIC PERFORMANCE OF RURAL AMERICA WHICH HAS NOT KEPT PACE WITH ADVANCES IN THE URBAN ECONOMY. A FEW FACTS ILLUSTRATE THIS POINT: ALTHOUGH RURAL AMERICA ACCOUNTS FOR 25% OF THE NATION'S POPULATION, IT HAS:

- o ONLY 20% OF U.S. PERSONAL INCOME;
- o MORE THAN 40% OF THE NATION'S ELDERLY;

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- o 38% OF THE NATION'S POOR;
- o 67% OF ALL SUBSTANDARD HOUSING; AND
- o UNEMPLOYMENT EXCEEDING TWICE THE NATIONAL AVERAGE.

SMALL BUSINESSES WILL PLAY A VITAL PART IN THE IMPROVEMENT OF RURAL AMERICA. ACCOUNTING FOR 48% OF OUR GNP AND 80% OF ALL NEW JOBS AS THEY DO, WE MUST ENCOURAGE THE ENTREPRENEURIAL SPIRIT IN THESE AREAS.

I LOOK FORWARD TO THIS MORNING'S TESTIMONY AND HOPE THAT THE OPINIONS SHARED WILL PROVIDE US GUIDANCE IN CRAFTING AN APPROPRIATE LEGISLATIVE RESPONSE TO THESE PROBLEMS.

THANK YOU, MR. CHAIRMAN.

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Senator BAUCUS. Our first witness is Mr. Frank Swain, who is the Chief Counsel for the Office of Advocacy of the SBA.

Mr. Swain, please proceed.

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. SWAIN. Chairman Baucus, Senator Dixon, thank you very much for the invitation to appear at these hearings. It is indeed an honor to appear and to lead off the hearings. I am not sure that we are the national experts on rural economic development, but we do appear here in the hopes that we can provide some information that will help the Subcommittee set a context for both the hearing today and hearings to come.

We do believe that the issue of development and diversification of the rural economy is a particularly important issue. I might add that inasmuch as it has been announced that the new Administrator for the SBA being proposed for confirmation is Senator Abdnor from South Dakota, and I am certain that he will have no less, and in fact a greater interest in that particular subject and will do everything he can to make sure that the SBA programs are fully and appropriately utilized.

I would like to suggest basically a factual context for the hearings in the sense that we have taken a look at where the jobs are coming from in rural areas, where they are coming from from the small business perspective. With the permission of the subcommittee, I would like to, rather than going over the statement verbatim, to simply summarize some of the key points.

Senator BAUCUS. You are encouraged to do so.

Mr. SWAIN. First of all, as the chart indicates, the last eight years have seen a significantly expanding economy in this country. The population has expanded somewhat. The employment has expanded considerably, the brown bar being the total employment at 19 percent.

[Charts are shown.]

Mr. SWAIN. However, if you take out Government and you take out agricultural industries, the employment in the rest of the economy indeed has expanded nearly 25 percent in the last several years.

On the other hand, of particular note to the rural situation is the fact that both the number of farm proprietors and the amount of farm employment has decreased considerably. So clearly, as your opening statement so clearly put it, the rural economy is in difficult shape and small business development has probably spent a good deal of effort in cushioning some of the blows that might have even been worse except for some prolific small business job generation in the rural areas.

One of the things that is interesting to note is that from the perspective of the small and large business, the rural areas of this country are not that much different than the urban areas. In fact, there has been significant growth. However, the growth in the rural areas has not been small business growth. The growth in the rural areas has been medium- and large-sized business growth.

Small businesses have really grown in the cities, and that growth has been particularly in services and in retailing.

As you can see, there is a 35 percent increase on small business employment in the metropolitan areas. But in the nonmetropolitan areas which, just for purposes of statistics, we roll together the Census definitions of "rural" and "nonmetropolitan," the small business growth has only been 18.2 percent on their employment base.

As you can see, the medium-sized business growth and the large business growth has been considerably healthier in rural areas than the small business growth. On the other hand, the small business growth in urban areas has been considerably healthier than in rural areas.

Our final chart is here to give you an idea as to where the actual jobs are coming from in rural areas. The largest number of jobs in rural areas that are being generated are in the services' businesses. Just as the rest of the economy is moving from a goods-producing base to a service-base, that is no less so in the rural economy.

Over a million jobs in the last eight years were generated by service businesses in the rural economy—about half by large business, about half by medium- and small-sized business. A number of those jobs, though, are in the health services field and in the educational services field in the rural areas. In urban areas, the big growth in service comes from business services, things like personnel services, computer software, and so on.

So it is clear that although there is a lot of services growth in the rural areas, it does have to do with some particularities of the population—certainly the fact that it is generally an aging population perhaps in greater need of health services is stimulating the growth of health services. The same can be said for educational services.

On the other hand, in trying to look for some good news or some interesting developments, we do see that in manufacturing the businesses that are growing in rural areas are small manufacturers, much more so than large manufacturers. We find this to be true probably because small manufacturers have been able to find markets outside of those immediate rural areas, and in effect export their products to urban markets, or occasionally overseas. But I am using "export" in the generic term, that if you have a small plant in a rural county in the middle of some State, they are certainly probably exporting their product to the largest city areas.

I think that it is interesting that small firms seem to be developing more along these lines than large firms. That is very much at odds to some degree with the national trend.

Finally, the retail sector. You can see that there has been tremendous growth in large firms in the retail sector, but almost no growth in small firms. Again, we attribute this more to changing consumer patterns than anything else, that the chain stores are inevitably taking over and being sought after by consumer choice, that the local mom and pop stores, the locally owned department store, is really not a growing entity at all.

However, the chain store, the discount store that is located in the mall perhaps in a suburban area or outside a medium-sized town,

seems to be the place where the consumers are more interested in going and shopping, and those stores are certainly expanding.

The small, locally owned store trades only on local consumer business is really not growing at all. So from the small business perspective there is a lot of growth in the service areas, although there is going to be a lot of competition with big business. There is a lot of growth in manufacturing, but not much growth in retailing at all.

To try to sum up, we feel that generally speaking small businesses have not been as significant in rural areas as they have been in urban areas. We think there is a lot of room for improvement. Small businesses have created about two out of three new jobs in this country, but that is not true out in the country. Maybe they have created half of the new jobs out in the country.

In order to get the rural areas going again, obviously we have got to get the small business job generation process heated up stronger than it is right now in rural areas.

We mention just three general policy points:

First of all, I think we need to help rural areas build on their comparative advantages. This will require creating new links between rural resources and manufacturing and service economies. This is already occurring to some degree. We have several examples that we list in our statement. I should say that that is really only the tip of the iceberg. We just made literally two or three calls and got a half-dozen examples of things that were going on stimulated by local Small Business Administration offices, local State departments of commerce and economic development, local universities and small business development centers. There is generally great concern in the rural areas of our country over economic diversification.

A second issue I believe is that we need to examine whether there are policies that prevent rural firms from fully participating in the growing service sector. Deregulation was mentioned. I think that deregulation has been a two-edged sword, quite possibly in the sense that transportation deregulation has had some localized unfortunate effects in some areas. On the other hand, the growth in home-based businesses and the deregulation of telecommunications has probably allowed businesses opportunities to locate in rural areas that would not have been true several years ago.

Other issues such as the increasing cost of liability insurance or whether States are making it too expensive to hire workers through the current trend towards mandating broader employee benefits I think tend to be factors that this Subcommittee should take a look at, as well.

Finally, we believe that we need to reconsider the ways in which we utilize existing Federal resources devoted to the rural economy. Government policy must be flexible enough to allow incentives to develop alternative enterprises in the rural economy. Simply stated, we pour a lot of Federal money into the rural economy for a variety of purposes. I do not come here as any expert on farm policy or programs at all.

I think it is an interesting question as to whether those monies that go into the rural economy are simply used to in effect resuscitate the farm industry which is on definitely hard times, or how

much those monies can be rechanneled to stimulate new businesses that might grow where the farms are not growing now. I think that is an important question.

[The prepared statement of Mr. Swain follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

STATEMENT OF

FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON THE RURAL ECONOMY

AND FAMILY FARMING

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

MARCH 5, 1987

SUMMARY

- Small business creates a majority of new jobs in rural America -- 56 percent of the 2.5 million jobs generated between 1976 and 1984.
- This growth has not been as dramatic as it has been in urban areas where small firms created 61 percent of the new jobs over the eight year period.
- The service sector is providing the most new jobs in rural areas -- 1.1 million jobs, with both large and small firms contributing to that expansion.
- In the manufacturing sector the small business sector has been especially strong. Small firms contributed 185,000 new manufacturing jobs in rural areas while large firms only generated 76,000 new manufacturing jobs.
- Governmental policies should promote diversification of the rural economy. While there are many initiatives currently providing assistance in this effort, we must examine all current rural policies and look for ways to make them flexible enough to allow incentives for new business development.

Mr. Chairman, I appreciate the opportunity to join you today as you address issues facing America's rural communities.

The agricultural and extractive industries generally are not healthy. Bankruptcies among businesses dependent upon the health of the farm, forestry, mining, and oil industries have increased. There is little doubt that the problems in these industries have had a severe impact on rural communities. However, the rural economy is not totally dependent on troubled industries. The service sector is expanding less quickly than in metropolitan areas. Small manufacturers have used the inherent advantages of rural communities to expand. A healthy rural economy depends on continued diversification and government policies that encourage this diversification.

Rural America, like small business, encompasses a diverse and dynamic collection of different communities. In the aggregate, 29.0 percent of the U.S. population and 25.5 percent of all jobs are found in the nonmetropolitan areas of the Nation.

Table 1
Outlines of Rural American

	Total	Metro	Nonmetro	Completely Rural
Population, 1980	226,546	163,526	63,020	2,737
Labor Force, 1980	106,085	78,797	27,287	1,111
Employment, 1980	97,639	72,682	24,958	1,023
Employment in primary industries (Agriculture, Forestry, fishing, mining), 1980	3,942	1,518	2,424	136

Note: All numbers are in thousands.

Source: Census of Population, 1980

The Shape of the Rural Economy: 1984

Manufacturing and retail trade employment provide a greater share of jobs in rural rather than urban areas. Manufacturing (32.9 percent), retail trades (21.2 percent), and services (20.8 percent) are the largest employers in rural areas (Table 2).

Table 2
Distribution of Nonagricultural Employment
Among Industries, 1984

	All Areas	Metro	Nonmetro
Agriculture	1.0	1.0	2.2
Mining	1.5	1.5	3.5
Construction	5.6	5.6	5.0
Manufacturing	26.3	26.3	32.9
Transportation	7.0	7.0	5.
Wholesale	6.9	6.9	5.7
Retail	18.3	18.3	21.2
Finance	7.2	7.2	3.1
Services	26.2	26.2	20.8
Total	100.0	100.0	100.0

Source: Small Business Data Base; U.S. Small Business Administration.

Note: This analysis is drawn from the Small Business Data Base (SBDB). The SBDB is based on records compiled by the Dun and Bradstreet Corporation (D&B) and encompasses virtually all employees in the nonfarm sectors of the economy. Most hired farm workers and farm family members are not included in the totals. Those employees included in the "agricultural" category are primarily those working in large commercial farming businesses which market their products under some brand name. These larger agricultural enterprises employ 859,000 of the 3.8 million agricultural employees reported by the Bureau of Economic Analysis for 1984. In addition to the employees identified here, there are 2.6 million farm proprietors. The terms "rural" and" nonmetropolitan" areas, as well as "urban" and "metropolitan" areas are used interchangeably. These terms were defined by the Office of Management and Budget in 1980. Of the 3,141 counties in the U.S., 725 were classified as metropolitan and 2,416 were identified as nonmetropolitan; 790 of the nonmetro counties are designated "completely rural."

Small businesses, those with fewer than 100 employees, provide 42.4 percent of all jobs in rural areas (Table 3). In effect, small firms are more significant, in terms of employment, to rural areas than to urban areas.

Small and medium size firms provide more than half (57.6 percent) of the jobs in rural America.

Table 3
Distribution of Nonagricultural Employment
by Size of Firm, 1984

	All Areas	Metropolitan	Nonmetropolitan
Small	39.0	38.1	42.4
Medium	13.9	13.7	15.0
Large	47.1	48.2	42.6
Total	100.0	100.0	100.0

Note: Small firms have fewer than 100 employees, medium firms between 100 and 499 employees, and large firms have 500 or more employees.

Source: Small Business Data Base; U.S. Small Business Administration.

Job Growth in Rural America: 1976-1984

The number of nonagricultural jobs increased at a slower rate between 1976 and 1984 in rural areas than in urban areas. Employment expanded by 21.0 percent in nonmetropolitan areas compared to the 25.7 percent growth in metropolitan counties (Table 4).

Table 4
Nonagricultural Jobs & Job Growth, 1976-1984

	Number of Counties	Employment (thousand)			
		1976	1984	Difference	Percent Change
Total	3,141	68,347	85,356	17,009	24.9
Metropolitan	725	56,226	70,693	14,467	25.7
Nonmetropolitan	2,416	12,122	14,664	2,542	21.0

Note: Small firms have fewer than 100 employees, medium firms between 100 and 499 employees, and large firms have 500 or more employees.

Source: Small Business Data Base; U.S. Small Business Administration.

The 21.0 percent growth in all nonmetropolitan counties masks a phenomenon that is important to this committee. Some of these nonmetropolitan counties are defined to be "completely rural," they contain no place with more than 2,500 people; there are 790 such counties. The 26.0 percent rate of job growth in these completely rural counties was the most rapid, of any geographic area from 1976 to 1984.

In a market economy, jobs exist in order to produce goods and services. Differences in the distribution of jobs and the patterns of job growth are bound up in the underlying economics of product and service markets.

Nationwide, between 1976 and 1984, 17.0 million jobs were added to the labor force; this constituted an increase of 24.9 percent. How this job growth was distributed between different industries, places, and size classes reveals some interesting differences.

In general, employment increased faster in metropolitan areas and in small businesses. Small firms grew faster (31.9 percent) than medium (23.4) and large (20.0) firms (Table 5). This pattern is dominated by the expansion of small firms

Table 5
Changes in Nonagricultural Employment, 1976-1984
(Percentage)

		Areas	
	U.S.	Metropolitan	Nonmetropolitan
Small Business	31.9	35.6	18.2
Medium Business	23.4	22.8	26.2
Large Business	20.0	19.7	22.1
Total	24.9	25.7	21.0

Note: Small firms have fewer than 100 employees, medium firms between 100 and 499 employees, and large firms have 500 or more employees.

Source: Small Business Data Base; U.S. Small Business Administration.

in urban areas. In nonmetropolitan areas medium sized businesses led the growth rate, but large firms added the greatest number of actual new jobs.[1]

Across the economy, manufacturing employment rose by 5.1 percent (Table 6). The decline of large metropolitan factories has been well publicized. Less obvious has been the expansion of small manufacturing firms. Jobs in small rural manufacturing businesses expanded by 21.0 percent.

Nationally, the number of retail trade jobs grew 16.6 percent between 1976 and 1984. Employment in small retail businesses grew more slowly than employment in the industry as

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[1]If only "small" and "large" firms were identified, using a 500 employee boundary, job growth in rural areas would be led by "small" business.

Share of Employment Growth 1976-1984

	Firms With		
	Fewer Than 500 Employees	More Than 500 Employees	Total
Rural	56.2	43.8	100.0
Urban	61.3	38.7	100.0
Total	60.5	39.5	100.0

a whole, and in rural areas, small retailers showed almost no growth. The restructuring of the retail trade industries are evident as large and medium size retail outlets are displacing the traditional small neighborhood stores in both urban and rural areas. Large retailers in rural areas grew most rapidly, and medium-sized retail firms expanded at a rate more than twice the national average.

Table 6
Nonagricultural Employment Changes 1976-1984

	(Percentage Changes)			Number of
	Total	Metropolitan	Nonmetropolitan	Nonmetro. Jobs
Manufacturing (U.S., 5.1%)				
Small	28.2	29.8	21.0	149,526
Medium	2.6	1.8	5.4	36,153
Large	-.9	-1.9	2.4	76,708
Retail Trade (U.S., 16.6%)				
Small	9.1	12.3	.4	8,722
Medium	26.7	24.4	39.4	73,626
Large	26.5	21.3	71.6	334,251
Services (U.S., 50.2%)				
Small	67.1	69.8	53.4	404,160
Medium	48.5	47.4	53.4	290,394
Large	56.1	53.1	89.3	491,332

Note: Small firms have fewer than 100 employees, medium firms between 100 and 499 employees, and large firms have 500 or more employees.

Source: Small Business Data Base; U.S. Small Business Administration.

Total service industry jobs increased by 58.2 percent between 1976 and 1984. The small firm work force grew faster than the number of workers in either large or medium sized firms. In metropolitan areas, small firms with 1-19 employees dominated growth with expansion rates of more than 75 percent. In rural areas, large service firms expanded service employment much more rapidly than small or medium-sized firms.

To promote diversification in rural economies there are at least three areas that I believe ought to be considered:

1. We need to help rural areas build on their comparative advantages. This will require creating new links between rural resources and manufacturing and service economies. This is already occurring as state, local and federal governments focus on the problem. A few examples are:

> Last weekend in Kirksville, Missouri, the SBA-funded Small Business Development Center sponsored a conference on "Agricultural Diversification." Attended by 450 people, the conference consisted of 26 workshops covering a wide range of finance, management and marketing topics.

A $47,500 grant to a Butte, Montana company under the Small Business Innovation Research program is exploring ways to produce biological pesticides at lower cost to counteract the gypsy moth. This contract may lead to commercial production of a mold known to combat a serious defoliant.

This coming Sunday, in Miles City, Montana, the Small Business Administration and the community college are cosponsoring a workshop on home-based businesses. On May 1, 1987, a regional conference on home-based businesses will be held in Missoula, Montana.

In Dodge City, Kansas, the Small Business Administration, the Department of Commerce, and the local university soon will hold a conference on international marketing.

2. We need to examine whether there are policies that prevent rural firms from fully participating in the growing service sector. These policies exist at the state, local and national level. For example:

Technological and regulatory changes in the telecommunications industry have dramatically reduced the costs of communications with distant markets.

permitting growth of information intensive industries such as publishing and data processing in rural areas. The tradeoff has been that prices for local services more closely reflect the cost of providing that service.

3. We need to reconsider the ways in which we utilize existing Federal resources devoted to the rural economy. Government policy must be flexible enough to allow incentives to develop alternative enterprises in the rural economy.

To remain competitive in the global economy, both rural and metropolitan economies must be competitive. Federal policies must promote flexibility and allow enterprises in rural and metropolitan America respond more efficiently to changing national and global markets.

A number of points should be highlighted. Rural America must diversify its economy. The rural economies must use their strength in the agricultural and extractive industries to further develop growth in the manufacturing sector. In turn, this internal growth will provide the base on which to build an expanding service sector which will further enhance and diversify the rural economy. Government policies must encourage this growth.

Questions and answers, Senator Pressler to Mr. Swain

1. THERE HAS BEEN A GREAT DEAL OF PRESS ATTENTION ON THE AGRICULTURAL ECONOMY. IN YOUR VIEW DO YOU FEEL THAT THE PRESS HAS DEPICTED THE PROBLEM AS IT REALLY IS? IF NOT, WHY NOT?

To the extent that the press has reported on the difficulties faced by rural economies and communities dependent on farming, ranching, logging, mining, and oil drilling, the reports have been accurate. However, the press has not told the entire story. As I mentioned in my testimony, the rural economy is very diverse and some sectors such as the service and manufacturing industries are expanding. Communities dependent on these expanding sectors are not in serious difficulty. The failure to report on the diversity and growth may give a distorted view of the entire rural economy.

DO YOU FEEL THE PRESS ATTENTION HAS HELPED AMERICANS LIVING IN MORE URBAN AREAS TO BETTER UNDERSTAND THE DRASTIC NATURE OF THE SITUATION?

I believe that any reporting on the rural economy is valuable in assisting Americans living in urban areas to understand the problems of the rural economy.

2. MANY SMALL BUSINESS OWNERS IN THE SMALLER COMMUNITIES OF SOUTH DAKOTA HAVE INDICATED TO ME THAT THEIR SALES WERE DOWN 40 TO 50 PERCENT. BASED ON YOUR KNOWLEDGE OF THIS SITUATION, WOULD YOU SAY THAT ALL RURAL AREAS OF THE COUNTRY HAVE BEEN EFFECTED IN A SIMILAR FASHION?

No. Many rural areas, particularly those in the Plains states, are experiencing an economic downswing. In other rural areas where the economy is not based solely on agriculture or mining, the economy has not been affected in the same way. For example, in Maine, business failures declined 23 percent in 1985 with an additional decline of 27 percent in 1986. This contrasts with Oklahoma, Texas, Missouri, and South Dakota whose business failures increased in 1986. A chart of business starts and failures is attached and provides a state-by-state breakdown.

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3. IF THE AGRICULTURAL ECONOMY REMAINS PRETTY MUCH AS IS, WILL THE LOSS OF MAIN STREET BUSINESSES CONTINUE AT THE CURRENT PACE?

To be sure, a depressed agricultural economy would adversely affect main street businesses in agriculturally dependent communities. Similarly, improvements in the agricultural economy would improve the economic outlook for main street businesses in those communities. There is no discernible trend in the business failure statistics for states with large agricultural sectors. Business failures declined in 1986 in some states with large farm sectors such as Iowa (-20.2%) and Nebraska (-25.3%). However, business failures increased in other states with large farm sectors such as Minnesota (+25.3%) and Missouri (+29.9%). In other states with large farm sectors, such as Wisconsin (1984 to 1985 +39.7%, 1985 to 1986 +9.7%) and Kansas (1984 to 1985 +121.2%, 1985 to 1986 +5.6%), the number of failures increased but the rate decreased. States with large farm and natural resource extraction sectors continued to show large increases in business failures. States in this category include Texas (+55.9%), Idaho (+53.2%), and Oklahoma (+174.9%).

As rural economies diversify, the main street of many towns can be expected to revive.

4. WON'T THE DEPRESSED ECONOMY IN SMALL RURAL COMMUNITIES SOON BEGIN TO AFFECT LARGER COMMUNITIES AND EVENTUALLY THE ENTIRE RURAL ECONOMY? IF YES, HOW LONG WILL IT BE BEFORE THIS CHAIN REACTION TAKES PLACE?

Larger rural communities and the entire rural economy will feel the effect of depressed rural economies to the extent that larger communities and the rural economy as a whole depend upon the health of the agriculture and extractive industries. However, the continuing diversification of the rural economy should reduce the dependence of rural communities on agriculture and extractive industries. In turn, this will lessen the adverse effects of depressed industries on the rural economy.

5. I KNOW THAT ENTERPRISE ZONES ARE ADMINISTERED BY HUD, BUT HAVE YOU HAD THE CHANCE TO STUDY THIS CONCEPT AT ALL? IF YES, MANY STATES HAVE SUCCESSFULLY EMPLOYED THE ENTERPRISE ZONE CONCEPT. THE ZONES HAVE PROVED HELPFUL IN REVITALIZING MANY OF THIS NATION'S INNER CITIES. DO YOU BELIEVE THEY COULD PROVE EQUALLY VALUABLE TO RURAL COMMUNITIES?

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Enterprise zones do not currently exist at the Federal level. Despite continuous Administration proposals, Congress has not acted on this legislation. Most enterprise zone proposals have provided for some portion of the enterprise zone benefits to be held separate for rural areas. We have studied the concept. Two reports have been completed for us: "Business Impacts of Enterprise Zones" by Cambridge Systematics and "Impact of Enterprise Zone Tax Incentives on Selected Small Business" by Coopers & Lybrand. In the absence of Congressional action, many states have gone ahead with their own state specific proposals.

The primary benefit of the enterprise zone designation under most state schemes and the proposed Federal law is a tax credit, deduction, or deferral. This benefit is useful to individual firms if they have taxable income. These benefits do not create demand for products, or by themselves, provide financing for diversification. As a part of broader efforts, however, the concept may well be useful to rural areas.

6. IN CONVERSATIONS I HAVE HAD WITH SMALL BUSINESS OWNERS IN SOUTH DAKOTA, SEVERAL SAID THEY HAD EXPERIENCED LARGE LOSSES DUE TO FARMERS FILING BANKRUPTCY. IN YOUR VIEW, IS THIS A NATIONWIDE PROBLEM?

Problems related to farm bankruptcies have been severe enough to cause losses for some small businesses. The business failure information provided in response to question 2, while not identical to bankruptcies, does illustrate the problem since this covers nonfarm businesses. Moreover, the recent addition of Chapter 12 to the bankruptcy code may partially minimize problems felt by nonfarm businesses insofar as Chapter 12's provisions permit family farms to continue in operation. The affects of farm bankruptcies on nonfarm businesses, while significant in some areas, does not appear to be a nationwide problem.

DOES THIS PROBLEM AFFECT A SIGNIFICANT NUMBER OF SMALL BUSINESSES?

Many small businesses in regions experiencing significant numbers of farm bankruptcy filings are adversely affected. The extent of the harm to these small businesses, absent the filing of bankruptcy by these businesses, has not been measured.

IS THIS TREND INCREASING?

Recent data, as evidenced by the decline in ~~bankruptcy filings~~ business failures, would suggest that the troubles of small businesses in agriculturally dominated counties are on the decline.

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7. IF YOU HAD ONLY ONE CHOICE, WHAT WOULD BE THE SINGLE BEST THING THE SBA OR ANY OTHER GOVERNMENTAL AGENCY COULD DO TO AID SMALL BUSINESSES AND COMMUNITIES THAT HAVE BEEN HAD HIT BY THE FARM PROBLEM?

The SBA should continue its efforts at helping farm-dependent communities diversify their economy. On a larger scale, increasing the competitiveness of American industry and reductions of the federal budget deficit would lead to a continued expansion of the economy which would help all sectors of the economy including those dependent on agriculture.

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Business Starts By State and By SBA Region,
1986 versus 1985

Region/State	1985	1986	Percent Change 1985-1986	Rank
U.S. Total	249,770	251,613	0.7	
Region I, Total	11,609	14,006	20.6	
Connecticut	3,223	3,877	18.6	6
Maine	814	1,011	24.2	3
Massachusetts	5,222	6,239	19.5	5
New Hampshire	1,074	1,415	31.8	2
Rhode Island	765	834	9.0	11
Vermont	511	685	34.1	1
Region II, Total	27,786	31,952	15.0	
New Jersey	8,596	10,342	20.3	4
New York	19,190	21,610	12.6	9
Region III, Total	22,413	23,871	6.5	
Delaware	548	531	-3.1	31
District of Columbia	880	848	-3.6	35
Maryland	4,766	5,134	7.7	12
Pennsylvania	9,136	9,810	7.4	15
Virginia	5,783	6,030	4.3	18
West Virginia	1,200	1,418	18.2	7
Region IV, Total	45,617	45,799	0.4	
Alabama	3,221	3,236	0.5	24
Florida	18,491	17,710	-4.2	38
Georgia	6,790	7,303	7.6	13
Kentucky	2,934	3,269	11.4	10
Mississippi	1,600	1,877	17.3	8
North Carolina	5,278	5,225	-1.0	27
South Carolina	2,801	2,865	2.3	21
Tennessee	4,502	4,314	-4.2	39
Region V, Total	39,444	38,878	-1.4	
Illinois	11,953	10,506	-12.1	44
Indiana	3,968	4,023	1.4	22
Michigan	8,144	8,496	4.3	19
Minnesota	3,521	3,535	0.4	26
Ohio	8,262	8,869	7.3	16
Wisconsin	3,591	3,449	-4.0	37
Region VI, Total	37,369	32,324	-13.5	
Arkansas	1,965	1,908	-2.9	33
Louisiana	4,402	4,141	-5.9	41
New Mexico	1,454	1,407	-3.2	34
Oklahoma	3,475	2,954	-15.0	49
Texas	26,073	21,914	-16.0	50
Region VII, Total	10,040	9,286	-7.5	
Iowa	1,963	1,678	-14.5	48
Kansas	2,515	2,191	-12.9	47
Missouri	4,424	4,316	-2.4	30
Nebraska	1,237	1,161	-6.1	42
Region VIII, Total	9,429	9,269	-1.7	
Colorado	5,265	5,242	-0.5	25
Montana	920	812	-11.7	45
North Dakota	453	448	-1.1	28
South Dakota	474	461	-2.7	32
Utah	1,796	1,731	-3.6	36
Wyoming	521	525	0.8	23
Region IX, Total	35,895	36,293	1.1	
Arizona	4,735	4,283	-9.5	46
California	29,937	29,953	3.2	20
Hawaii	1,019	1,065	4.5	17
Nevada	1,204	1,092	-9.3	43
Region X, Total	10,167	9,925	-2.3	
Alaska	1,018	705	-30.7	51
Idaho	1,071	1,017	-5.0	40
Oregon	3,767	3,975	5.5	14
Washington	8,311	8,228	-1.0	29

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Business Failures By State and By SBA Region, 1984-1986

Region/State	1984	1985	1986	Percent Change 1984-1985	Percent Change 1985-1986
U.S. Total	52,078	57,252	61,160	9.6	6.8
Region I, Total	1,203	1,228	1,115	2.2	-9.2
Connecticut	274	307	262	12.0	-14.7
Maine	105	80	58	-23.8	-27.5
Massachusetts	513	683	734	33.5	7.5
New Hampshire	102	60	54	-41.2	-10.0
Rhode Island	104	60	37	-44.2	-38.3
Vermont	55	38	30	-30.9	-21.1
Region II, Total	3,263	2,840	2,415	-13.3	-15.0
New Jersey	1,005	990	905	-1.4	-8.6
New York	2,358	1,850	1,510	-20.9	-18.4
Region III, Total	3,684	3,571	3,045	-3.5	-14.7
Delaware	82	86	86	5.0	0.0
District of Columbia	66	60	69	-7.6	15.0
Maryland	522	450	462	-14.8	2.7
Pennsylvania	1,769	1,651	1,558	-7.4	-6.0
Virginia	916	991	685	8.2	-30.9
West Virginia	329	367	225	8.0	-38.9
Region IV, Total	7,569	7,917	7,749	4.2	-2.1
Alabama	771	808	809	4.8	0.1
Florida	2,588	2,793	3,315	7.9	18.7
Georgia	721	954	607	32.5	-36.4
Kentucky	787	983	945	23.5	-3.9
Mississippi	387	467	503	21.4	7.7
North Carolina	763	665	584	-13.1	-12.2
South Carolina	246	230	262	-6.5	13.9
Tennessee	1,326	1,217	1,144	-8.5	-6.4
Region V, Total	9,529	10,501	10,217	9.8	-2.7
Illinois	2,626	2,802	2,777	6.0	-0.9
Indiana	853	1,245	1,082	44.9	-13.1
Michigan	1,806	1,665	1,607	-19.3	-9.7
Minnesota	599	506	634	-14.9	25.3
Ohio	2,606	2,456	2,052	-6.1	-16.4
Wisconsin	1,019	1,427	1,565	39.7	9.7
Region VI, Total	5,609	8,200	12,980	47.5	58.9
Arkansas	573	622	372	7.9	-40.2
Louisiana	858	1,384	1,823	61.9	31.7
New Mexico	245	258	267	65.7	3.4
Oklahoma	825	1,830	2,831	23.0	174.9
Texas	3,108	4,906	7,647	57.4	55.9
Region VII, Total	2,488	4,147	4,317	66.7	4.1
Iowa	395	830	652	110.6	-21.2
Kansas	712	1,583	1,671	121.2	5.6
Missouri	1,275	1,247	1,620	-2.3	29.9
Nebraska	106	487	364	357.5	-25.3
Region VIII, Total	3,459	3,977	4,536	15.0	14.1
Colorado	2,340	2,993	3,701	27.9	23.7
Montana	177	194	183	9.6	-5.7
North Dakota	117	94	98	-19.7	4.3
South Dakota	60	145	150	141.7	3.4
Utah	522	577	570	11.1	-1.2
Wyoming	243	274	281	12.8	2.6
Region IX, Total	11,717	1,607	11,455	-1.3	-1.1
Arizona	891	992	982	11.0	-1.0
California	10,434	10,235	10,150	-1.7	-0.8
Hawaii	225	251	282	9.3	12.4
Nevada	367	367	361	-1.4	-1.6
Region X, Total	3,437	3,364	3,371	-2.2	0.2
Alaska	185	173	188	-6.5	8.7
Idaho	175	203	211	16.0	4.0
Oregon	1,731	1,581	1,580	-8.6	-0.1
Washington	1,606	1,607	1,712	0.1	6.5

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Senator BAUCUS. Thank you very much.

We are joined this morning by Senator Boren of Oklahoma who has a statement to make.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator BOREN. Thank you very much, Mr. Chairman.

I am very interested in the remarks just made by Mr. Swain, and I apologize. I have to go now and testify on a bill which I am the principal sponsor of, S. 2, over in the Rules Committee. I hope to be able to return and hear the rest of the testimony by the excellent panels you have put together.

I want to commend you for scheduling these hearings, and I think they really will give us some insights and some improved perspective on the rural economy. As we all know, we have a problem. We have roughly 25 percent of the population with only 20 percent of the income. That translates in other figures in terms of 38 percent of the poverty, and 40 percent of them elderly citizens. So we do have a severe problem, and I commend you for holding these hearings.

I hope I can rejoin you, and I would like to submit a statement for the record.

Senator BAUCUS. Without objection.

Thank you very much, Senator.

[The prepared statement of Senator Boren follows:]

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STATEMENT OF SENATOR BOREN

Mr. Chairman:

I want to thank you for calling this hearing on "New Perspectives on the Rural Economy". The state of our rural economy has been overlooked by many of our national leaders of late. I firmly believe that a great portion of the blame for our depressed rural economy lies in our failed farm policies. I would like to submit for the record a very specific and detailed speech on our agriculture policy I made on the occasion of our most recent "National Agriculture Day". While that speech was given in 1986 the situation has not changed - in fact it has worsened.

However, there is an additional emerging problem with our rural economy. We are beginning to see a shift from rural dependence on farming to other, and in some cases related industries. There is no doubt that the economic performance of rural America has not kept pace with advances in the urban economy. As a result the standard of living in rural America is falling behind that of our more urban areas. As has been pointed out before, and will no doubt be discussed throughout today's hearings, with only 25% of the population rural America has over 40% of our nation's elderly, only 20% of the net personal income, and over 38% of our nation's poor.

If we continue on with our past policies Mr. Chairman, the future doesn't look promising. In Oklahoma alone during the past 2 years over 36 banks have failed. Over 70% of those banks can be classified as rural institutions. No one can deny that those failures are a direct result of a farm policy gone astray. Agriculture and our rural economy are inextricably linked. We

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must then find someway to play to the strengths of the basic structure of our rural economy. We must find someway to diversify our rural economy by expanding upon the natural foundation that agriculture provides. If we can accomplish that Mr. Chairman, and I think we can, then we will have gone a long way towards solving the chronic economic problems plaguing rural America as well as bringing much needed stability and growth to our national economy.

I would also like to include in the record some comments which I made in regard to agricultural and rural policies on National Agriculture Day last year.

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NATIONAL AGRICULTURE DAY

MR. BOREN.

MR. PRESIDENT, YESTERDAY WAS NATIONAL AGRICULTURE DAY, A DAY OFFICIALLY RECOGNIZED BY THE PRESIDENT AND THE CONGRESS AS A DAY OF "OBSERVANCE AND CELEBRATION" OF AMERICAN AGRICULTURE.

MR. PRESIDENT, ON THIS, THE SIXTH NATIONAL AGRICULTURE DAY, I "OBSERVE" THAT THERE IS VERY LITTLE TO "CELEBRATE."

AGRICULTURE IS IN THE WORST CRISIS SINCE THE GREAT DEPRESSION OF THE THIRTIES. IN SOME WAYS, CONDITIONS ARE WORSE. JUST 35 YEARS AGO, NET FARM INCOME FOR ONE YEAR WOULD HAVE MORE THAN PAID OFF TOTAL FARM DEBT. THIS PAST YEAR THE DEBT WAS OVER SIXTEEN TIMES AS MUCH AS ANNUAL INCOME. IN 1950, NET FARM INCOME WAS $19 BILLION AND TOTAL FARM DEBT WAS $12.5 BILLION. IN 1983, NET FARM INCOME HAD FALLEN TO $5.4 BILLION WHILE TOTAL FARM DEBT HAD SKYROCKETED TO $216.3 BILLION. THIS PAST YEAR, NET FARM INCOME FELL 20 PERCENT. 1986 NET FARM INCOME IS EXPECTED TO BE 33 PERCENT LOWER THAN NET FARM INCOME FOR 1981. FOR THE PAST SIX YEARS, AMERICAN FARMERS HAVE HAD VERY LITTLE CASH INCOME WITH WHICH TO ATTEMPT TO SERVICE A HUGE DEBT. AT THE SAME TIME, THE FARMER'S ABILITY TO

BORROW IS DECLINING BECAUSE SO MANY FARMS ARE BEING FORCED ONTO THE MARKET.

THE VALUE OF AGRICULTURAL LAND HAS FALLEN 38 PERCENT IN THE LAST FOUR YEARS. IT IS IMPORTANT TO NOTE THAT THIS PERCENTAGE DECLINE NECESSARILY INCLUDES LAND NEAR URBAN AREAS WHICH ARE BEING CONVERTED FROM FARMLAND TO LAND FOR OTHER USES, SUCH AS APARTMENTS AND SHOPPING CENTERS. THE INCLUSION OF THIS LAND IN THE ESTIMATE, THOUGH UNAVOIDABLE, BLANKETS THE FACT THAT IN MANY COUNTIES, DEPENDENT TOTALLY UPON AGRICULTURE, LAND VALUES HAVE FALLEN OVER 50 PERCENT IN THE PAST COUPLE OF YEARS. AS LAND VALUES HAVE FALLEN, MORE AND MORE FARMERS FIND THEIR EQUITY ERODED TO UNACCEPTABLE LEVELS. IN THE PAST FIVE YEARS, WE HAVE SEEN MORE THAN A 200 PERCENT INCREASE IN FARM BANKRUPTCIES AND FORCED LIQUIDATIONS.

AS EQUITY HAS ERODED, MANY FARMERS WHO ARE COMPLETELY CURRENT ON THEIR DEBT PAYMENTS ARE BEING THREATENED WITH FORECLOSURE. I WOULD LIKE TO BE ABLE TO SAY THAT THIS IS NOT HAPPENING, THAT FARMERS WHO ARE CURRENT WILL NOT BE FORECLOSED UPON. REGRETFULLY, I AM AWARE OF TWO CASES THIS PAST YEAR WHERE FARMERS WERE FORECLOSED ON EVEN THOUGH THEY WERE CURRENT ON THEIR PAYMENTS. MANY FARMERS' EQUITY HAS ERODED TO THE POINT OF BEING UNABLE TO SUPPORT THE AMOUNT OF DEBT OWED, DESPITE BEING CURRENT ON THEIR PAYMENTS. BEFORE A FARMER CAN BORROW MONEY, HE MUST SHOW THAT HE HAS SUFFICIENT COLLATERAL TO COVER THE AMOUNT OF THE LOAN. IN SOME AREAS OF THE COUNTRY, LAND VALUES

HAVE FALLEN SO DRASTICALLY THAT THE PRESENT VALUE OF THE LAND WILL NOT COVER THE CURRENT DEBT-LOAD, MUCH LESS COVER THE AMOUNT OF AN OPERATING LOAN NEEDED TO PUT IN THIS YEAR'S CROP.

AT THE PRESENT TIME, IT APPEARS VERY LIKELY THAT WE HAVE YET TO REACH THE BOTTOM OF THE DECLINE IN LAND VALUES. THE FURTHER THE VALUE DECLINES, THE MORE FARMERS, CURRENT ON DEBT PAYMENTS, THAT ENTER FORECLOSURE STATUS. THE MORE FARMERS THAT ARE FORECLOSED UPON, THE MORE LAND THAT GOES ON THE MARKET. MR. PRESIDENT, WE ARE AT THE EDGE OF A VICIOUS DOWNWARD SPIRAL WHICH THREATENS TO BRING DOWN THE ENTIRE ECONOMY OF THIS COUNTRY.

THERE ARE MANY WHO CLAIM THAT WE ARE MERELY GETTING RID OF "INEFFICIENT" FARMERS. I ASSURE YOU, WE GOT RID OF THE INEFFICIENT FARMERS YEARS AGO. THE FARMERS THAT ARE GOING OUT OF BUSINESS TODAY ARE FARMERS WHO HAVE BEEN SUCCESSFUL FOR TWENTY YEARS OR MORE. THE FARMERS THAT ARE BEING FORCED OUT OF FARMING TODAY, ARE FAMILY FARMERS, THOSE WHO GET UP AT 4:00 IN THE MORNING DURING CALVING SEASON, THOSE WHO WORK UNTIL TWO OR THREE IN THE MORNING TO GET THEIR CROPS HARVESTED BEFORE RAIN. THESE ARE THE FARMERS THAT ARE GOING UNDER TODAY.

TWENTY-NINE PERCENT OF ALL FARM DEBT, APPROXIMATELY $62 BILLION, IS OWED BY FARMERS WITH DEBT-TO-ASSET RATIOS OVER 70 PERCENT. THIRTY-THREE PERCENT OF ALL FARM DEBT, APPROXIMATELY $71 BILLION, IS OWED BY FARMERS WITH DEBT-TO-ASSET RATIOS OF 40-70 PERCENT.

TWENTY PERCENT OF ALL FARMS, 129,000 FARMS, SHOW FINANCIAL STRESS. ABOUT 320,000 FARMS, OR 18.9 PERCENT OF ALL FARMS, HAVE A DEBT-TO-ASSET RATIO OF 40 PERCENT. 196,000 FARM, 11.6 PERCNET, HAD DEBT-TO-ASET RATIOS OF 40-70 PERCENT. 123,000, OR 7.3 PERCENT, WERE HIGHLY LEVERAGED AND TECHNICALLY INSOLVENT WITH DEBT-TO-ASSET RATIOS GRATER THAN 70 PERCENT. 51,000 OPERATORS, OR 3 PERCENT OF ALL FARMS, HAD DEBT-TO-ASSET RATIOS OVER 100 PERCENT.

TWENTY-SEVEN PERCENT OF OUTSTANDING COMMERICAL BANK DEBT WAS HELD BY BORROWERS WITH DEBT-TO-ASSET RATIOS OVER 70 PERCENT.

IN 1982, THERE WERE 4112 COMMERICAL BANKS CLASIFIED AS AGRICULTURAL BANKS HAVING MORE THAN 25 PERCENT OR MORE OF THEIR PORTFOLIO IN AGICULTURAL LOANS. IN JUNE, 1985, THER WERE ONLY 3930. IN 1983, THERE WERE 133 POTENTIALLY VULNERABLE AGRICULTURAL BANKS. BY 1985, THERE WERE 302. IN JUNE OF 1983, THERE WERE 106 PROBLEM AGRICULTURAL BANKS. BY OCTOBER 1985, THE NUMBER OF PROBLEM AGRICULTURAL BANKS HAD INCREASED BY OVER 400 PERCENT, TO 413 BANKS.

THE PERCENTAGE OF BANK FAILURES THAT ARE AGRICULTURAL INCREASED DRAMATICALLY FROM 15.9 PERCENT IN 1983 TO 59.5 PERCENT IN THE FIRST TEN MONTHS OF 1985. FIFTY-TWO OF THE 62 AGRICULTURAL BANKS THAT FAILED IN 1985 WERE LOCATED IN A SIX-STATE AREA INCLUDING NEBRASKA, IOWA, KANSAS, OKLAHOMA, MINNESOTA, AND MISSOURI. IN 1982, ONLY SEVEN

AGRICULTURAL BANKS FAILED; IN 1983, THERE WERE SEVEN, AND IN 1984 THERE WERE 25.

BY THE END OF 1985, NEARLY 40 PERCENT OF PROBLEM COMMERCIAL BANKS WERE AGRICULTURAL BANKS, UP FROM 24 PERCENT TWO YEARS EARLIER. UNDER A LOW-MEDIUM LOSS SCENARIO, ABOUT 70 AG BANK FAILURES COULD BE EXPECTED IN 1986 AND 60 IN 1987. UNDER A HIGH LOAN LOSS SCENARIO, IT IS ESTIMATED THAT ABOUT 150 FARM BANKS WOULD FAIL IN EACH OF THE NEXT TWO YEARS.

UNDER PRESENT CONDITIONS, IT WOULD TAKE AVERAGE PRICE INCREASES OF OVER 30 PERCENT TO RESTORE ALL FAMILY-SIZE COMMERCIAL FARMS TO POSITIVE NET CASH FLOWS. GIVEN THE TREMENDOUS INCREASE IN SURPLUS STOCKS AND RAPIDLY DECLINING LEVEL OF EXPORTS, IT IS DOUBTFUL THAT WE WILL EXPERIENCE ANY INCREASE IN INCOME THIS YEAR AND POSSIBLY NOT EVEN NEXT YEAR.

MR. PRESIDENT, THE NEWS FROM OKLAHOMA IS NOT ENCOURAGING. REAL FARM INCOME CONTINUES TO DECLINE, ALONG WITH FARMLAND VALUES WHICH DECREASED 14% IN 1985 AND 38% FROM THE HIGH IN 1982. PRICES RECEIVED BY FARMERS CONTINUE TO DECLINE RELATIVE TO PRICES PAID BY FARMERS, FURTHER ERODING PROFITABILITY. COMMODITY PRICES FOR 1985 FELL 10%, THE WORST SINCE 1953. REAL INTEREST RATES REMAIN HIGH. THE VALUE OF TOTAL FARM ASSETS WILL CONTINUE TO DECLINE, BUT PERHAPS AT A SLOWER RATE.

THE FEDERAL RESERVE BANK OF KANSAS CITY REPORTS BANKING EXTIMATES INDICATING 3.1% OF THE FARMERS AND

RANCHERS IN THE DISTRICT WENT OUT OF BUSINESS LAST FALL, THREE TIMES WHAT BANKERS CONSIDER "NORMAL". PARTIAL LIQUIDATIONS WERE UP BY NEARLY FIVE TIMES THE NORM. SOME 25 OKLAHOMA BANKS HAVE FAILED SINCE 1982, MANY OF THEM RURAL BANKS WITH LARGE FARM LOAN PORTFOLIOS.

AN ESTIMATED 25% OF OKLAHOMA'S FARM AND RANCH FAMILIES ARE IN FINANCIAL DIFFICULTY. PER COUNTY, ABOUT 100 ARE IN SEVERE CONDITION AND 120 ARE APPROACHING SEVERE PROBLEMS. FARM FORECLOSURES AND BANKRUPTICIES ARE 9-10 TIMES "NORMAL" IN THE BANKING REGION THAT INCLUDES OKLAHOMA.

FARM POPULATION IN THE U.S. DECLINED 7% IN 1985, THE SHARPEST DROP IN A DECADE, AND OKLAHOMA SHARED IN THAT DECLINE. AS OF JANUARY 1986, 9400, OR 18.1% OF FmHA BORROWERS IN OKLAHOMA WERE DELINQUENT ON PAYMENTS.

WHY HAS THE CRISIS REACHED THIS POINT? IN PART, I BELIEVE IT IS BECAUSE MANY AMERICANS DO NOT UNDERSTAND THE ECONOMICS OF AGRICULTURE OR THE IMPORTANCE OF THE FARM SECTOR TO THEM PERSONALLY. THEY DO NOT KNOW THAT TO START AN AVERAGE FAMILY FARM TODAY REQUIRES OVER $425,000 IN CAPITAL. THE MAJORITY OF THE AMERICAN PEOPLE BELIEVE THAT THEY ARE SUBSIDIZING THE FARMER. IN ONE SENSE, THE TAXPAYERS HAVE SUBSIDIZED FARMERS THROUGH PROGRAMS WHICH HAVE COST FAR MORE THAN THEY SHOULD DUE TO SHORT-SIGHTED FARM POLICIES.

IN THE LARGER SENSE, IT IS THE FARM SECTOR WHICH IS SUBSIDIZING THE REST OF THE COUNTRY. THE FACTS ARE

CLEAR. AGRICULTURE IS THE MOST PRODUCTIVE AND MOST EFFICIENT SECTOR OF OUR NATION'S ECONOMY. ADDITIONALLY, OUR FARMERS HAVE BEEN GIVING AMERICANS THE GREATEST FOOD BARGAIN IN THE WORLD. AMERICANS SPEND ONLY 15 PERCENT OF THEIR INCOME FOR FOOD. THE AVERAGE RUSSIAN SPENDS 45 PERCENT FOR FOOD. EVEN IN GREAT BRITAIN THE AVERAGE IS ABOUT 28 PERCENT. AMERICAN FOOD CONSUMERS GET MORE FOR THEIR MONEY TODAY THAN IN 1950.

IN GREAT PART, AMERICAN CONSUMERS HAVE RECEIVED THESE BENEFITS DUE TO THE DRAMATIC INCREASES IN THE PRODUCTIVITY OF OUR FARMERS. AT THE BEGINNING OF THIS CENTURY, ONE FARMWORKER COULD ONLY FEED SEVEN PERSONS. BY 1970, THIS ONE FARMWORKER SUPPLIED ENOUGH FOOD AND FIBER FOR 73 PEOPLE. IN THE PAST 15 YEARS, THE PRODUCTIVITY OF THIS ONE FARMWORKER HAS SKYROCKETED. A FARMER IN AMERICA NOW FEEDS 116 PEOPLE. THIS INCREASED AGRICULTURAL PRODUCTIVITY, THE RISE IN OUTPUT PER UNIT OF INPUT, HAS BEEN A MAJOR CONTRIBUTOR TO IMPROVED LIVING STANDARDS FOR AMERICANS. AS AGRICULTURAL PRODUCTIVITY HAS INCREASED, CONSUMERS HAVE BEEN ABLE TO UPGRADE THEIR DIETS AT A LOWER COST.

THE ECONOMIC ACTIVITY OF AGRICULTURE EMPLOYS 21 MILLION PEOPLE AND ACCOUNTS FOR 20 PERCENT OF THE NATION'S GROSS NATIONAL PRODUCT.

IT IS CONSISTENTLY ONE OF THE FEW SECTORS OF OUR ECONOMY WHERE WE HAVE A FAVORABLE TRADE BALANCE.

FARMERS ARE SO PRODUCTIVE THAT THEY PRODUCE FOOD FOR THE U.S. POPULATION, ABOUT A THIRD LARGER THAN A QUARTER CENTURY AGO, AND DO IT WITH THE OUTPUT FROM LEWER FARM ACRES. MEANWHILE, FARMERS HAVE INCREASED THE ACRES PLANTED FOR EXPORT BY NEARLY 75% IN THOSE 25 YEARS.

FARMERS HAVE A BIG STAKE IN FARM EXPORTS, BUT SO DO NON-FARMERS. EVERY ADDITIONAL $1 BILLION OF FARM EXPORTS CREATES ANOTHER $1.37 BILLION OF ECONOMIC ACTIVITY IN THE U.S., FOR A TOTAL OF $2.37 BILLION. EACH ADDITIOANL $1 BILLION IN FARM TRADE MAKES JOBS FOR 30,000 TO 35,000 OR MORE PEOPLE.

THE JOBS ARE ON FARMS--AS WELL AS IN SUPPLYING FARM PRODUCTION INPUTS FOR FARMERS; IN LOCAL AND LONG-DISTANCE TRANSPORTATION BY TRUCK, RAIL, RIVER BARGES, AND OCEAN-GOING SHIPS; PROVIDING FINANCING ALL ALONG THE WAY, ALONG WITH AREHOUSING AND INSPECTION; PROCESSING; AND OTHER ACTIVITIES. IN 1984, 1.1 MILLION FULL-TIME U.S. JOBS RELATED TO AGRICULTURAL EXPORTS.

EVEN IF YOU DON'T HAVE AN EXPORT-RELATED JOB, YOU HAVE A STAKE IN AGRICULTURAL EXPORTS. FARM EXPORTS HAVE EXCEEDED FARM IMPORTS CONTINUOUSLY SINCE 1960. THAT HELPS OFFSET THE GROWING U.S. NEGATIVE BALANCE OF TRADE FROM NON-FARM FOREIGN TRADE, WHICH HAS HAD A CONTINUOUS DEFICIT SINCE 1971. THE DOLLARS FROM THE FAVORABLE BALANCE OF TRADE IN FARM EXPORTS ARE USED TO PAY FOR IMPORTS OF CONSUMER GOODS.

FARMERS, HOWEVER, HAVE BEEN ABSORBING THE COST OF PROVIDING THESE BENEFITS TO THE REST OF THE NATION, USUALLY SELLING BELOW THEIR ACTUAL COST OF PRODUCTION AND BY GOING BROKE IN RECORD NUMBERS. FARMERS ONLY RECEIVE 27 CENTS OF THE CONSUMERS' FOOD DOLLAR SPENT FOR FOOD RAISED ON U.S. FARMS, DOWN FROM 33 CENTS 20 YEARS AGO.

WHEN WE HAVE RECORD NUMBERS OF FARMERS GOING BANKRUPT, OUR ENTIRE ECONOMIC SYSTEM IS THREATENED. WHEN LAND VALUES COLLAPSE, BANKS WHOSE LOANS ARE SECURED BY THE LAND GET IN TROUBLE, AND SMALL BUSINESSES START TO FOLD. THIS POSSIBLE DOMINO EFFECT IS CHILLINGLY REMINISCENT OF THAT WHICH BEGAN ON THE FARMS IN THE LATE 1920s AND SPREAD ACROSS THE NATION IN THE DEPRESSION OF THE 1930s. HISTORY HAS SHOWN THAT THE GREAT DEPRESSION OF THE THIRTIES WAS "FARM LED AND FARM FED." RIGHT NOW, WE ARE FACED WITH A REPEAT OF THAT NATIONAL DISASTER.

LAST YEAR, WE LOST ABOUT 4 PERCENT OF OUR FARMERS. AS A RESULT, LAND VALUES IN THE FARM BELT FELL OVER 10 PERCENT. IF WE LOSE 10 TO 15 PERCENT IN ONE YEAR, AS SOME PREDICT COULD HAPPEN THIS YEAR, IT IS NOT HARD TO IMAGINE WHAT WILL HAPPEN TO LAND VALUES AND SUBSEQUENTLY TO THE ECONOMY AT LARGE.

WHAT CAN BE DONE? NO ONE CAN PRETEND TO HAVE ALL THE ANSWERS, BUT SOME STEPS CLEARLY MUST BE TAKEN. FIRST OF ALL, WE SIMPLY MUST IMPROVE FARM INCOME. THE BEST WAY TO PREVENT FORECLOSURES AND MASS LIQUIDATIONS OF ASSETS IS TO IMPROVE A FARMER'S ABILITY TO REPAY HIS DEBTS. MORE

CREDIT, MORE LOANS TO FARMERS WILL NOT RESOLVE THE PROBLEM; RATHER, IT WILL ONLY DELAY AN INEVITABLE CRISIS. THE ONLY WAY TO AVOID THE CRISIS IS TO RAISE FARM INCOME. IT IS ALSO THE CHEAPEST AND MOST EFFICIENT WAY TO HELP FARMERS STAY IN BUSINESS.

SECONDLY, WE MUST ENACT A CREDIT PROGRAM THAT HELPS FARMERS RESTRUCTURE THE DEBT THEY ALREADY HAVE. WITH LAND VALUES DECLINING RAPIDLY, MANY FARMERS WON'T BE ABLE TO STAY IN BUSINESS UNLESS THEY ELIMINATE A PORTION OF THEIR DEBT. IN MOST CASES, IT IS CHEAPER FOR THE LENDERS TO WRITE-OFF A PORTION OF THE BORROWER'S DEBT THAN IT IS TO FORECLOSE ON THE BORROWER WHEN LAND VALUES HAVE FALLEN DRAMATICALLY.

THIRD, WE MUST BRING DOWN FEDERAL BUDGET DEFICITS SO THAT FARMERS CAN BORROWER MONEY AT A REASONABLE RATE OF INTEREST. ADDITIONALLY, BRINGING DOWN FEDERAL BUDGET DEFICITS WILL IMPROVE OUR ABILITY TO EXPORT MORE AGRICULTURA COMMODITIES BY COMBATING THE OVERVALUED DOLLAR.

FINALLY, WE SHOULD DEVELOP A LONG-RANGE, MULTI-YEAR POLICY AIMED AT PRESERVING OUR FAMILY FARMERS BY ALLOWING THEM TO RECEIVE A FAIR PRICE FOR THEIR PRODUCTS. WE DID ENACT SOME IMPROVEMENTS IN FARM POLICY LAST YEAR AS PART OF THE 1985 FARM BILL. HOWEVER, CONGRESS FAILED TO ADEQUATELY ADDRESS THE CURRENT PROBLEMS OF IMPROVING INCOME FOR FARMERS TODAY. BEFORE THE LONG-RANGE POLICIES OF THE FARM BILL ARE IMPLEMENTED, MOST OF THE FAMILY

FARMERS WILL NOT BE AROUND. THE FOOD SECURITY ACT OF 1985 WILL LOWER FARM INCOME FOR THE FIRST THREE OR FOUR YEARS. MOST FARMERS CANNOT SURVIVE THE TRANSITION PERIOD.

MR. PRESIDENT, FOR MANY OF US, THE PROBLEMS OF AGRICULTURE SEEM TOO DIFFICULT TO RESOLVE. HOWEVER, WE HAVE FACED CHALLENGES IN THIS COUNTRY BEFORE AND WE HAVE ALWAYS RISEN TO MEET THE CHALLENGES SUCCESSFULLY. MAINTAINING FAMILY FARMS IS NOT IMPOSSIBLE, BUT IT WILL REQUIRE DETERMINED ACTION AND BIPARTISAN WORK. IT IS MY HOPE THAT ALL OF US CAN BAND TOGETHER AND TACKLE THE PROBLEMS OF THE FAMILY FARMER.

Senator BAUCUS. Senator Pressler.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator PRESSLER. Mr. Chairman, I would like to begin by congratulating Senator Baucus, this Subcommittee's new Chairman. I look forward to working under his able leadership during the 100th Congress.

As chairman of this Subcommittee during the last Congress, I held hearings which explored the current problems of the farm economy and their impact on small communities' main street businesses. For some time, those of us from agricultural States have understood that the economic crisis in rural America is as severe for local businesses and entire communities as it is for farmers and ranchers.

I felt it was critical to establish an official hearing record which would vividly illustrate this link. While the media continues to report on the economic resurgence in this country, we cannot afford to forget that this recovery has missed most of rural America.

It has been well documented that the crisis faced by our farmers and ranchers is not limited to their operations. Many small communities in South Dakota and other rural States are experiencing extreme difficulties as a result of the loss of farmers and ranchers. Every displaced farm family means a loss of business for grocery stores, cafes, hardware stores, and every other small-town main street business. Many are forced out of business, which serves only to aggravate the problem.

The disappearance of farms, ranches, and small businesses has led to a decline in school enrollment and local tax revenue. The amount of property with delinquent taxes in rural areas has increased substantially in recent years. If this trend is not reversed, many small rural communities will become ghost towns. There is a real need for action on rural development which will complement what we do with the farm program.

As a member of the Republican Task Force on Farm and Rural America, a group of Midwest Governors, Senators, and Congressmen I have participated in meetings held in Des Moines, IA; Chicago; and Washington, DC, over the past several months. The meetings were designed to foster discussion on initiatives and policy options affecting agriculture and rural America.

To effectively deal with the crisis we must find ways to diversify the economies of agricultural States and provide education and vocational training opportunities for farmers, ranchers, and other rural citizens. Some States have already begun work in that direction. However, in order to meet the challenges of the situation, the Federal Government must work in concert with States and private enterprise.

It is also vital that this process establish policies which will ensure that basic, necessary services such as health care, transportation, and communication facilities are available to rural communities. As a Member of the Commerce, Science, and Transportation

Committee, I am well aware of the struggle to expand the infrastructure in rural counties and smaller cities and towns.

To this end, the Task Force has called upon the President to establish a White House Conference on the future of rural America. I do not have to tell my colleagues on this Subcommittee what kind of impact such conferees can have. I think we would all agree that last year's White House Conference on Small Business provided a wealth of extremely timely and thoughtful recommendations.

A conference on rural America would undoubtedly be extremely helpful in developing initiatives aimed at revitalizing our rural communities. The White House Conference. The White House Conference on Small Business made some very specific recommendations and highlighted the fact that product liability and tort reform was foremost in the minds of our small businessmen. A White House conference on rural development could do the same, not just for farms but for our small towns, businesses, hospitals, and communications.

We should also explore such concepts as rural enterprise zones. During the last Congress I co-sponsored legislation which would have created such a program. Many States have successfully employed the enterprise zone concept. The zones have proved helpful in revitalizing many of this Nation's inner cities. I believe they could be equally valuable to rural communities.

Diversification of the economies in agriculturally dependent States is vital. It is not enough to simply offer programs designed to retrain some of our farmers and ranchers. Training without jobs is not only useless, but also cruelly holds out false hope. We must find ways to encourage new business to come to rural America.

Small business continues to be a dominant force in this Nation's economic resurgence. In 1985, employment growth in small business-dominated industries reached a level of just over 5 percent. This far outpaced the growth in large business-dominated industries which saw an increase of new jobs of less than 1 percent. Thus, small business is the key to successful, long-term economic diversification.

I know that many feel a competition between small business and big business. I have been one who said our antitrust laws should be more vigorously enforced. On the other hand, many small businessmen hold the dream of growing and eventually selling out to a bigger business. There are functions which are better performed by a big business such as the manufacture of automobiles, but the vitality of the Nation depends upon small business, and we should keep that in mind. The two need each other, and are synergistic.

I look forward to receiving the testimony of the witnesses here today, and thank them for taking the time to appear before this subcommittee. Today's hearing will further demonstrate the severity of rural America's problems and help Congress develop policies which will finally allow our agricultural sector to join the rest of the country's growing prosperity.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator.

Mr. Swain, does the SBA work up data on the degree to which its programs—for example, the Guaranteed Loan Program—are allocated to rural as opposed to urban areas?

Mr. SWAIN. We can, Senator. We just did not have time to do it before this particular hearing, but I would imagine within a matter of three or four weeks we could give you, or give the subcommittee a report on the number of loans closed to recipients in rural versus nonrural counties.

Senator BAUCUS. Does the SBA, as a matter of course, work up this data, or not?

Mr. SWAIN. No, not as a matter of course. There is an allocation, of course, geographically that the State of Montana has a certain number of loans allocated to it. Within the State of Montana, there is not an allocation on how many loans are closed in the urban areas versus the rural counties of that particular State. There is a geographic allocation to every SBA District Office, and we certainly have the data on that. We could report that to the Subcommittee immediately.

Senator BAUCUS. Do you know the degree to which other agencies break out a compilation for data between urban and rural allocations, as opposed to State?

Mr. SWAIN. I know that the Agriculture Department does it to a fare thee well, because of course that is their business of tracking what goes into individual counties. I do not, off the top of my head, know for instance whether you could ask HHS on what amount of Medicare dollars goes to rural counties as opposed to urban counties.

I think to the extent that the data is coded by county and the Agriculture Department can identify every—there is a computer program that identifies what is rural and what is not rural—it probably could be done in most circumstances. But whether it is routinely done, I do not know.

Senator BAUCUS. Do you think it is a good idea for agencies, as a matter of course, to do that—particularly in view of the recent trend of migration and development of the Coastal States and the Sunbelt States at the expense of the hinterland? Does it seem to make some sense to do that, or not?

Mr. SWAIN. Well, I can only speak for my own agency. I think it certainly does make sense for us to do it. We certainly can and will do it for communities, if you are interested.

Senator BAUCUS. Well, we are interested. I would appreciate it if you could, please. We would like to get that data.

[Material follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

April 28, 1987

Honorable Max Baucus
Chairman
Subcommittee on the Rural Economy and
Family Farming
Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

During the March 5 hearing of the Small Business Subcommittee on the Rural Economy and Family Farming, I promised to furnish the Committee information regarding the distribution of Small Business Administration 7(a) loan guarantees among metropolitan and nonmetropolitan counties. The distribution of Small Business Administration 7(a) loan guarantees in FY 1986 is almost exactly proportional to the number of businesses located in nonmetropolitan settings, and more than proportional to the rural population and number of jobs in rural areas.

In 1986, the Small Business Administration guaranteed $2,535,045,960 of loans under the 7(a) authority. Of that amount, $674,837,977 or 26.6 percent were loans made to businesses located in nonmetropolitan counties.

United States businesses located or headquartered in nonmetropolitan counties were 27.8 percent of the total, in 1984, according to the Small Business Data Base maintained by the Office of Advocacy.

Businesses located outside of metropolitan areas are, on average, smaller than businesses located in more populous areas. Nonmetropolitan employment in 1984 accounted for 17.2 percent of total employment. The Small Business Administration 7(a) guarantees in 1986 to businesses in nonmetropolitan counties are more than proportional to employment in those counties (26.6 percent of guarantees versus 17.2 percent of employment). A similar conclusion holds when the proportion of 1986 Small Business Administration 7(a) guarantees to nonmetropolitan businesses (26.6 percent) is compared to the 1985 population share in nonmetropolitan areas (23.8 percent).

I appreciate being able to respond to the Committee's request for this analysis. Please let me know if we can provide any further information.

Very truly yours,

Frank S. Swain
Chief Counsel for Advocacy

Attachment

NONMETROPOLITAN* SHARE OF SBA 7(a) LOANS, FY 1986

State	Number of Nonmetropolitan Loans	Number of Loans	7a Loans in State (Dollars)	Total Loans to Business in Nonmetropolitan Counties (Dollars)	Total Loans to Businesses in Nonmetropolitan Counties as a Percent of Total Loans in State
U.S., TOTAL	3,974	14,505	$2,535,045,960	$674,837,977	26.6%
ALABAMA	21	106	19,260,357	4,115,942	21.4%
ALASKA	84	253	62,046,391	20,079,950	32.4%
ARIZONA	18	214	44,682,819	3,267,425	7.3%
ARKANSAS	55	99	15,516,000	8,797,000	56.7%
CALIFORNIA	90	1,967	384,695,538	15,602,087	4.1%
COLORADO	95	264	49,360,305	18,690,531	37.9%
CONNECTICUT	9	74	13,840,000	1,043,000	7.5%
DELAWARE	9	25	3,878,600	1,578,200	40.7%
FLORIDA	10	245	50,487,629	2,352,500	4.7%
GEORGIA	63	404	58,504,228	13,186,900	22.5%
HAWAII	8	74	11,066,750	828,500	7.5%
IDAHO	106	169	25,574,500	17,202,500	67.3%
ILLINOIS	97	501	101,895,161	22,774,500	22.4%
INDIANA	62	231	40,848,800	12,420,900	30.4%
IOWA	371	626	81,023,699	46,007,406	56.8%
KANSAS	233	528	72,280,250	30,014,500	41.5%
KENTUCKY	85	175	30,271,764	16,468,364	54.4%
LOUISIANA	35	121	20,444,500	6,736,100	32.9%
MAINE	96	152	26,986,900	17,014,800	63.0%
MARYLAND	5	100	17,058,837	1,040,000	6.1%
MASSACHUSETTS	23	323	47,030,150	3,985,000	8.5%
MICHIGAN	49	175	40,072,179	13,913,542	34.7%
MINNESOTA	83	201	38,530,685	16,760,350	43.5%
MISSISSIPPI	32	68	9,800,450	4,798,050	49.0%
MISSOURI	225	780	104,358,136	30,280,110	29.0%
MONTANA	316	409	62,664,479	48,754,092	77.8%
NEBRASKA	110	245	31,037,100	13,591,400	43.8%
NEVADA	9	80	11,707,197	949,500	8.1%
NEW HAMPSHIRE	81	145	32,724,900	17,028,100	52.0%
NEW MEXICO	75	202	37,154,098	16,114,500	43.4%
NEW YORK	193	855	137,033,019	25,190,358	18.4%
NORTH CAROLINA	45	138	25,394,451	9,081,632	35.8%
NORTH DAKOTA	62	99	13,919,050	8,470,450	60.9%
OHIO	63	446	78,233,741	10,419,550	13.3%
OKLAHOMA	48	191	38,357,742	9,711,162	25.3%
OREGON	32	114	18,337,250	6,513,100	35.5%
PENNSYLVANIA	41	397	66,056,673	6,928,785	10.5%
RHODE ISLAND	9	81	14,358,100	1,205,000	8.4%
SOUTH CAROLINA	45	102	18,287,011	8,769,211	48.0%
SOUTH DAKOTA	145	185	25,799,150	20,664,700	80.1%
TENNESSEE	47	200	46,919,234	14,266,684	30.4%
TEXAS	176	1,169	203,901,568	33,220,689	16.3%
UTAH	55	181	30,990,016	9,766,516	31.5%
VERMONT	140	183	30,057,773	23,101,171	76.9%
VIRGINIA	10	67	11,453,700	1,527,000	13.3%
WASHINGTON	48	267	42,730,900	8,695,220	20.3%
WEST VIRGINIA	32	70	13,702,600	6,812,000	49.7%
WISCONSIN	125	430	102,550,820	29,754,700	29.0%
WYOMING	103	120	18,492,300	15,344,300	83.0%

* Nonmetropolitan includes counties defined as nonmetropolitan and rural under Department of Agriculture definitions.

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Senator BAUCUS. Next, and more fundamentally, the figures show that more and more people in small towns in rural America are earning a higher proportion of their income from nonfarm sources. Why is that?

Mr. SWAIN. Well, it would seem it would be for two reasons. One reason obviously, an initial reason, is that the farm income is not as adequate as it at one time was. So there is a certain economic necessity for finding other sources of income.

I think a second reason has to do with the general boom in entrepreneurship in small business startups, anyway, regardless. Even if the farm income were just fine, I think you would be seeing more people getting involved in business activities just as many more women are starting businesses now than started businesses 20 or 30 years ago. So I think there is a natural interest in entrepreneurship, and things like home-based businesses are booming, and we need to do more to develop that.

So part of it is driven perhaps by economic need for the agricultural economy, but part of it is driven by the fact that more and more people are saying, "I wonder what it would be like to go into business," and "I will give it a try." Those are the people that we have to help out, obviously.

Senator BAUCUS. I would like your views, too, on this decoupling phenomenon. That is, that many businesses in rural America are not primarily, or perhaps even secondarily, dependent upon basic primary resource industries—namely, fishing, agriculture, mining, et cetera. There is a common assumption that most businesses, most small business in rural America is directly related.

There certainly is some tie, but I wonder if you could go into the degree to which you think that businesses in rural America are in fact decoupled from basic primary resource industries. And second, whether you think there is a trend. And third, what explains that trend. That is, the phenomenon of increased decoupling.

Mr. SWAIN. I think that traditionally, in this century anyway, the rural businesses have been primarily resource-based, agricultural or mining or timber, or they have been retail businesses or service businesses that have served that local resource-based community.

Certainly the trend is away from that. The trend is there are clearly some, and we could get you some more precise figures as to what the proportion of businesses in the rural economy that are related to the traditional resources businesses.

But the trend has been—certainly, we think the growth in manufacturing has not been all manufacturing that is based on the timber industry or based on the mining industry. It has probably been some assembly operations, where people find labor conditions better, people more interested in working, various other conditions better in rural areas than in urban areas.

So I think that the trend from what we see is towards a more diverse economy. I think that the reasons for that are to some degree because local communities are now, and local planning people, are talking this up and providing opportunities as much as they can, because people look at the farm economy, the rural economy, and make the conclusion, for right or for wrong, there is limited growth there, I am going to try something different.

Yet, the rural lifestyle still holds an attraction for a lot of people and they do not necessarily feel they have to move off to the big city to start their business. I think that the changes particularly in telecommunications have facilitated that.

We would see the trend absolutely increasing towards diversification. I should add, though, that the one trend based on the local economy, based on the local resource economy, that is increasing is tourism, to the extent that tourism is a reflection of the natural in an area. The preliminary figures that we have seen—and the Commerce Department keeps a lot of figures on this—shows that tourism is an increasingly important economic factor in rural areas. And almost all businesses that are involved in tourism are small businesses.

Senator BAUCUS. I appreciate that. An interesting statistic is that 1983, 72 percent of the total farm family income is from non-farm sources. That is a growing trend.

It is also the same statistic for Japan. Japan, only a couple of years ago, learned that 70 percent of the Japanese farmer's income is in from non-farm sources. In Japan, most non-farm income is derived from jobs in town, either on a daily basis or a seasonal basis, a husband or a wife or someone in the family.

We know how important agriculture is to Japan. It is too important in many respects. But it is interesting how that phenomenon is developing.

Nor does that diminish the importance of agriculture in this country. We do not have a good farm program here. It is not working now and we have to make it work much better.

But at the same time, we have to diversify because the inexorable trend, is more toward knowledge-based industries and industries where technology is changing rapidly.

And there are many opportunities all over the country, particularly, I think, in rural areas, where people want to live, just to get away from folks. I think that there is a real opportunity there.

Mr. SWAIN. That is an important point, Senator. Just as a perspective, I think that I looked up—the commodity program was a $26 billion program last year. The SBA guaranteed loan program is a $2.4 billion, $2.6 billion program.

So in the sense of proportion, there is a lot of Federal money going into the rural economy focused directly at agriculture. And I am not saying that that is good, bad, or indifferent. But we think that we are using some good resources from the SBA, but we hope that other Federal programs certainly are flexible enough to encourage people to start businesses as well.

Senator BAUCUS. I see we have been joined by the Senator from Minnesota, Senator Boschwitz, and Senator Kasten.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Mr. Chairman, thank you, and congratulations on holding this hearing. All of us have got schedules and we are going back and forth between meetings. I would like to make just a very brief statement if I could.

I wanted to welcome the members of the panel who will testify before the Subcommittee. As a Senator from a largely rural state, I regard the future of both the farm and the rural non-farm sectors of America's economy as being subjects of vital importance.

We in Congress must spare no effort to keep family farmers on the land. Neither should we ignore the need of farm families for off-farm income and for strong, growing rural communities.

I do not think that anyone in Congress disagrees with this. The question is how best to work toward the goal of a healthy rural economy. I would like to make two suggestions that reflect the perspective that we bring from Wisconsin.

Unlike a number of other farm States, Wisconsin farmers depend overwhelmingly on just one commodity. That is milk. Wisconsin is the most efficient milk producing State located near the Country's largest milk consuming markets. The dairy industry is worth over $3 billion to the state's economy. Wisconsin has almost as many dairy farmers as the next three largest milk producing States combined.

So no other state depends on this industry as much as Wisconsin does. My neighbor from Minnesota would be close, but Wisconsin is the leader.

Senator BOSCHWITZ. I am just shocked when you talk about the efficiency of your farmers. [Laughter.]

Senator KASTEN. I will repeat that statement. Wisconsin is the most efficient milk producing State.

Our Federal dairy program, Mr. Chairman, should reflect the importance of the dairy industry to Wisconsin and the upper Midwest. I note with interest, I have had a chance to review Dr. Pulver's testimony. I am not going to be able to be here for his testimony. But a passage with regard to price-centered farm programs that direct the largest benefits to the largest farms. I might say I know that that has been an interest of yours as well in terms of legislation.

In no other program is this more true than the dairy program, and that is a fact that has concerned me for a long time. Accordingly, I am going to be soon introducing legislation to replace the current dairy program with a target price deficiency payment program. This program would direct income support to the small and midsize family farms that predominate both in Wisconsin and in the nation as a whole, rather than to the large milk factories and processors, as the current program does.

My second point is that, as much as we deplore it, farms do fail and people are forced off the land. And I think we are seeing this clearly in Wisconsin and we cannot pretend that it is not there.

These individuals must not be left without options. Especially troubling is the case of many older farmers who farmed all their lives and may not be trained for non-farm work. We in Congress must look at ways to work with state and local governments, as well as the private sector, to ensure that these farmers have the job retraining they need to take productive and dignified jobs after leaving agriculture.

Mr. Chairman, once more I commend you for holding this hearing and I regret that I am not going to be able to be here for much of your testimony.

Senator BAUCUS. Thank you, Senator. Your statement will be included.

[The prepared statement of Senator Kasten follows:]

STATEMENT BY
THE HONORABLE ROBERT W. KASTEN, JR.
SUBCOMMITTEE ON RURAL ECONOMY
COMMITTEE ON SMALL BUSINESS
HEARING HELD THURSDAY, MARCH 5, 1987

Mr. Chairman, I too would like to welcome the distinguished members of the panels who will testify before the subcommittee this morning on "New Perspectives on the Rural Economy."

As a Senator from a largely rural state, I regard the future of both the farm and the rural non-farm sectors of America's economy as being subjects of vital importance. We in Congress must spare no effort to keep family farmers on the land. Neither should we ignore the need of farm families for off-farm income and for strong, growing rural communities.

I do not believe that anyone in Congress disagrees with this. The question is, how best to work toward the goal of a healthy rural economy?

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I WOULD LIKE TO MAKE 2 SUGGESTIONS THAT REFLECT THE PERSPECTIVE I BRING FROM WISCONSIN.

UNLIKE MANY OTHER FARM STATES, WISCONSIN FARMERS DEPEND OVERWHELMINGLY ON 1 COMMODITY -- MILK. WISCONSIN IS THE MOST EFFICIENT MILK-PRODUCING STATE LOCATED NEAR THE COUNTRIES LARGEST MILK-CONSUMING MARKETS. THE DAIRY INDUSTRY IS WORTH OVER $5 BILLION TO THE STATE'S ECONOMY; WISCONSIN HAS ALMOST AS MANY DAIRY FARMS AS THE NEXT 5 LARGEST MILK-PRODUCING STATES COMBINED. NO OTHER STATE DEPENDS ON THIS INDUSTRY AS MUCH AS WISCONSIN DOES.

OUR FEDERAL DAIRY PROGRAM SHOULD REFLECT THE IMPORTANCE OF THE DAIRY INDUSTRY TO WISCONSIN AND THE UPPER MIDWEST. I NOTED WITH INTEREST A PASSAGE IN DR. PULVER'S TESTIMONY WITH REGARD TO PRICE-CENTERED FARM PROGRAMS THAT DIRECT THE LARGEST BENEFITS TO THE LARGEST FARMS. IN NO PROGRAM IS THIS MORE TRUE THAN THE DAIRY PROGRAM, A FACT THAT HAS CONCERNED ME FOR SOME TIME.

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ACCORDINGLY, I WILL SOON BE INTRODUCING LEGISLATION TO REPLACE THE CURRENT DAIRY PROGRAM WITH A TARGET PRICE-DEFICIENCY PAYMENT PROGRAM. THIS PROGRAM WOULD DIRECT INCOME SUPPORT TO THE SMALL TO MID-SIZED FAMILY FARMS THAT PREDOMINATE BOTH IN WISCONSIN AND IN THE NATION AS A WHOLE, RATHER THAN TO LARGE MILK FACTORIES AND PROCESSORS AS THE CURRENT PROGRAM DOES.

MY SECOND POINT IS THAT, MUCH AS WE DEPLORE IT, FARMS DO FAIL AND PEOPLE ARE FORCED OFF THE LAND. THEY MUST NOT BE LEFT WITHOUT OPTIONS. ESPECIALLY TROUBLING IS THE CASE OF MANY OLDER FARMERS WHO HAVE FARMED ALL THEIR LIVES AND MAY NOT BE TRAINED FOR NON-FARM WORK. WE IN CONGRESS MUST LOOK AT WAYS TO WORK WITH STATE AND LOCAL GOVERNMENTS, AS WELL AS THE PRIVATE SECTOR, TO ENSURE THAT THESE FARMERS HAVE THE JOB RETRAINING THEY NEED TO TAKE PRODUCTIVE, DIGNIFIED JOBS AFTER LEAVING AGRICULTURE.

MR. CHAIRMAN, THAT CONCLUDES MY STATEMENT. I COMMEND YOU FOR HOLDING THIS HEARING AND WILL REVIEW THE TESTIMONY PRESENTED HERE TODAY WITH GREAT INTEREST.

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Senator BAUCUS. Senator Boschwitz.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. Well, I have no formal opening statement. I very much agree with the Senator from Wisconsin.

It is interesting to note that dairy farms have declined in number very substantially. Twenty-five years ago, 26 years ago, there were 2,100,000 dairy farms, and most recently there are 300,000. It really reflects a change from the old days, when you pulled by hand, and more modern machinery allows herds to expand.

And after you have been out in the barn milking cows twice a day, the dignified jobs that these farmers are willing to accept are very reasonable. And that is not to say there is no dignity out in the barn. By no means do I say that.

But nevertheless, I also compliment you, Mr. Chairman, for holding hearings on the rural economy. It is a difficult situation. It is a little difficult for us because the further you come out our way, the further you move away from the markets. If you draw a 500 mile circle around any point in Montana, I suppose you would hit four or five percent of the people in the United States.

But yet, if you draw a 500 mile circle around southern Wisconsin or Columbus, Ohio, you hit 40 percent. So the options become better as you move away from our neck of the woods.

I am very interested in the testimony. I will not be able to stay for all of it, but I will indeed read it and absorb it.

Senator BAUCUS. Thank you very much, Senator.

Thank you, Mr. Swain. We appreciate your testimony.

The next panel are two distinguished individuals: First, Mr. Ken Deavers, who is Director of the Agriculture and Rural Economics Division of the ERS at USDA; and second, Mr. Pat Choate, Director of Policy Analysis of TRW and the author of a widely acclaimed book, "High Flex Society. '

Mr. Deavers, why do you not proceed first.

STATEMENT OF KENNETH L. DEAVERS, DIRECTOR OF AGRICULTURE AND RURAL ECONOMICS DIVISION, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. DEAVERS. Thank you, Mr. Chairman. I appreciate the opportunity today to discuss with the Subcommittee the current economic situation in rural America. I submitted for the record a statement and, rather than read that, what I would like to do is summarize some of the key points in that.

Senator BAUCUS. Without objection.

Mr. DEAVERS. During the 1970's, non-metropolitan counties experienced a period of unprecedented employment and population growth, accompanied by a substantial narrowing of differences in median family income levels between metro and non-metro areas.

In contrast, the economies of non-metro areas in the 1980's have performed much less successfully. At least three measures of economic performance indicate that non-metro areas have lagged metro areas since 1979.

First, metro employment growth was three times as rapid as non-metro employment growth, 10 percent versus 3 percent.

Second, for 1985, the last year for which we have complete data, the average annual non-metropolitan unemployment rate was over 9 percent, 2 percentage points higher than that for metro areas. Almost 1,100 non-metro counties now have annual average unemployment rates over 9 percent, compared to 300 in 1979.

Finally, the non-metro poverty rate was 18.3 percent in 1985, compared with 12.7 percent for metro areas. While the metro poverty rate has fallen during the recovery from the recession of the early 1980's, the non-metro poverty rate has been virtually unchanged.

Associated with this relatively poor performance of the non-metro economy, population growth in non-metro areas has now also receded to a level below that of our metro areas, and internal migration in the United States now favors metro areas.

Data for 1984 show a non-metro net migration loss to metro areas of about 350,000 persons, and almost half of all non-metro counties lost population during 1983 to 1985.

Slow employment growth, evidence of labor market stress, and population loss in the 1980's have been closely associated with structural adjustments occurring in rural manufacturing, in mining and energy industries, and in the agricultural sector.

Together, these sectors employ about 35 percent of all our non-metro citizens, and about half of all non-metro residents live in counties which are economically dependent on one or more of these three industries. Because of the community-wide impact of economic restructuring in agriculture, mining, energy, and manufacturing, counties dependent on these sectors have experienced a small decline in total employment since 1979.

When these counties are left out, non-metro America's performance in the 1980's looks much better. Employment growth of 8 percent from 1979 to 1985, nearly as rapid as for our metro counties.

Given what we know about the economic adjustments occurring in rural America, I would like to review briefly three considerations which I think have to guide the discussion of public policy.

First, the rural economy is now an integral part of the national and global economy. That means that traditional sector specific and community specific policies are less able to deal with the problems I have discussed. We cannot build rural prosperity by propping up certain sectors or firms in an effort to protect them from a highly competitive world economy.

Such policies are costly, in the long run they stifle creativity and new enterprise, and they reduce real wealth. Instead, in my judgment the highest priority needs to be given to macro policies that achieve the highest possible rates of overall economic growth consistent with reasonable price stability.

No set of specific development-oriented policies will be able to overcome inadequate growth of aggregate demand in the U.S. and worldwide.

Education, communications and transportation policies are also key to rural development, and income maintenance programs will determine the well-being of many of the rural poor. Rural interests are not likely to be paramount in shaping these policies, but great

care is needed to assure that rural areas are not inadvertently disadvantaged by the policies we create.

Second, rural areas are diverse. Economic stress is not the experience for all rural counties in the 1980's. Adjustments are heavily concentrated in the agriculture, mining, and manufacturing dependent counties, and in the persistent poverty counties which have always been outside the mainstream of economic development and largely unaffected by previous programs of regional development. Thus, careful targeting of the limited funds available for rural economic development is essential.

Growth patterns in the U.S. economy generally do not appear to favor large increases in the share of goods producing employment. Thus, there is little reason to believe that the expansion or location of manufacturing enterprises in rural areas will play a principal role in solving existing economic stress.

This raises serious questions about the appropriateness of national policies that finance traditional kinds of goods producing industry-serving infrastructure and that promote programs of local smokestack chasing.

There is some evidence that the recent decline in the dollar is stimulating exports of manufactured goods. However, the long term effects on the rural economy are unclear.

On the one hand, rural manufacturing, particularly in the South, tends to be in non-durable goods such as textiles and apparel. The primary competition for these industries comes not from Japan or Western Europe, but from Taiwan, Korea, and other countries whose currencies are tied to the value of the dollar. Thus rural employment in these industries may be stimulated very little by the decline in the dollar.

Agriculture faces a similar situation with respect to grain exports. The dollar has depreciated little against the currencies of many importers and has appreciated against the currencies of many export competitors.

Whatever programs are adopted need to reflect realistic expectations about the potential futures of individual rural areas, which are determined to some extent by their place in economic space and the degree of urbanization of the region of which they are a part. These programs need to accommodate futures of stability and orderly decline, not just of growth.

The role of State government has been substantially enhanced by the difficulty of addressing the diversity of rural conditions with national policies and programs.

Finally, Mr. Chairman, most of the burden of the economic adjustments occurring in rural America falls on human resources—displaced industrial workers, displaced farmers, and other proprietors, and members of their households. Problems of job loss are made worse by difficulties that individual workers face in shifting from production jobs to white collar jobs in the service sector.

Skills gained in farming, in mining, and in blue collar manufacturing frequently are of little direct use in the services sector. Also, pay scales are substantially lower in many parts of that services sector. Those who succeed in making the transition may have to accept changes in lifestyles, as well as changes in job tasks, and some may have to move their residence to find new jobs.

Rural workers, particularly in agriculture, are more likely to have been self-employed, often in an enterprise which spans several generations. This also makes occupational shifts more difficult.

Thus, human resource policies are critical to successful amelioration of the current rural economic stress.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Deavers follows:]

Statement by
Kenneth L. Deavers, Director
Agriculture and Rural Economics Division
Economic Research Service
U.S. Department of Agriculture
before the
Senate Committee on Small Business
Subcommittee on the Rural Economy
March 5, 1987

Thank you Mr. Chairman I appreciate the opportunity to discuss with the Subcommittee the current economic situation in rural America. My testimony today will focus on changes in employment, unemployment, and population in nonmetropolitan counties. My analysis covers the period since 1979, which was the peak year of the previous economic expansion of the U.S. economy.

During the 1960's and 1970's, the rural economic base was transformed from a primary dependence on natural resource activities, including agriculture, to a dependence on manufacturing and services. This shift was so great that even many farm operators spend a major part of their time working off the farm, and farm families as a group now receive nearly 50 percent of their cash income from nonfarm sources. Relatively greater dependence on goods production--the kinds of rural manufacturing industries and jobs within these industries--and sharp declines in natural resource-based industries and agriculture, have been the principal causes of economic stress in rural America in the 1980's. Indicators of rural economic stress include:

- Metro employment grew three times as fast as nonmetro employment during 1979-85 (10 vs. 3 percent), a reversal of the 1970's when nonmetro employment grew more rapidly. Nonmetro population growth also lagged behind metro growth in

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the 1980's, and net migration favored metro areas. Both of these conditions are also a reversal of the 1970's.

- For 1985, the nonmetro unemployment rate averaged above 9 percent, more than 2 percentage points higher than the metro rate. The nonmetro unemployment rate has fallen much more slowly than the metro rate during the current economic expansion.
- The nonmetro poverty rate was 18.3 percent in 1985 compared with 12.7 percent for metro areas. While the metro rate has fallen during the recovery from the recession of the early 1980's, the nonmetro rate has been virtually unchanged.

By 1984, more than 22 percent of all U.S. wage and salary manufacturing employment was in nonmetro America; roughly 40 percent of our rural citizens live in counties primarily dependent on manufacturing (Map 1). The manufacturing sector has experienced significant job losses as part of the current structural realignment. In many nonmetro areas, wage gains in manufacturing have outstripped productivity gains, leaving the industries vulnerable to foreign competition. A rise in the value of the dollar exacerbated our competitive problems. Problems in manufacturing include:

- Overall there was a 6-percent decline in U.S. manufacturing employment between 1979 and 1985. But white collar manufacturing employment grew by 10 percent, while blue collar manufacturing employment declined by 15 percent.
- The decline in blue collar manufacturing jobs is particularly serious for nonmetro areas because blue collar jobs are 75

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MAP 1

Manufacturing-Dependent Counties

Manufacturing-Dependent Counties
Manufacturing contributed 30 percent or more of total labor and proprietor income in 1979.

Standard Metropolitan Statistical Area

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percent of nonmetro manufacturing employment compared to 59 percent for metro areas.

- Total employment in nonmetro counties dependent on manufacturing grew by less than 1 percent between 1979-85.

Agriculture and mining counties (Maps 2 and 3) also have been under severe stress in the 1980's--farming counties because of the depressed economic conditions and accompanying financial problems and equity loss in the sector; mining counties because of the failure of OPEC production controls and pricing strategies, and general weakness in prices and markets for other minerals. As a result, mining- and agriculture-dependent counties experienced declines in total employment during 1979-85 of 6.5 percent and 0.3 percent, respectively.

These statistics reflect the community-wide impacts of economic restructuring in agriculture, mining, and manufacturing. Service-producing employment has been growing everywhere, but much more slowly in nonmetro counties dependent on these industries than in others. When counties dependent on agriculture, mining, and manufacturing are left out, nonmetro America's performance in the 1980's looks much better--employment growth of 8 percent from 1979-85--nearly as rapid as for our metro counties.

The data in Table 1 show how widespread are the problems affecting the agriculture, mining, and manufacturing sectors. Over one-half of mining- and manufacturing-dependent counties have average annual unemployment rates above 9 percent. And for the persistent poverty counties whose 1979 median family income level was only 60 percent of the U.S. level, more than 80 percent now have these high levels of unemployment. Equally important, the data in Table 1 appear to reflect a fundamental shift in the competitive

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MAP 2

Farming-Dependent Counties

Farming Dependent Counties
Farming contributed a weighted annual average of 20 percent or more to total labor and proprietor income over the five-year period from 1975 to 1979

Standard Metropolitan Statistical Area

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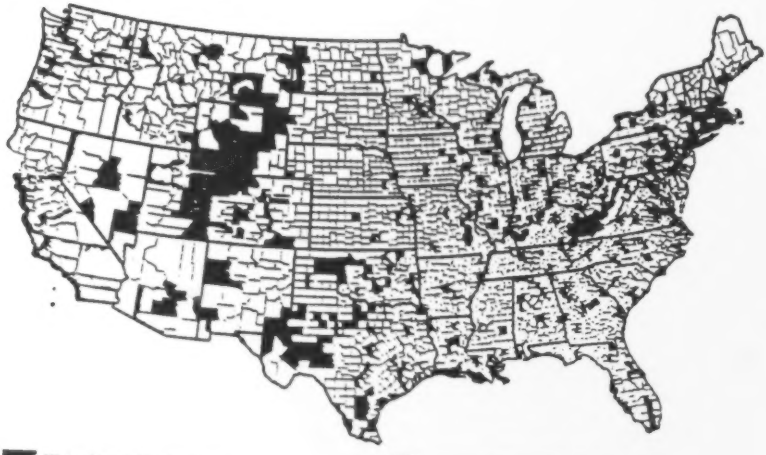
MAP 3

Mining-Dependent Counties



Mining-Dependent Counties
Mining income 20 percent or more of total labor and proprietor income in 1979

Standard Metropolitan Statistical Area

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Table 1. Number of Counties with annual average unemployment rates over 9.0 percent, 1979 and 1985

County types	1979	1985	Total number of counties by type
All Metro	33	154	654
All Nonmetro	307	1063	2443
Ag. Dependent	53	202	702
Mfg. Dependent	88	377	678
Mining Dependent	31	119	200
Poverty	69	195	242
Retirement	82	224	515

Source: Bureau of Labor Statistics.

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position of these rural economies since 1979, which was the peak of the previous economic expansion. The average annual nonmetro unemployment rate is now 8.4 percent compared to 5.7 percent in 1979.

In addition to the adjustments already discussed, the nonmetro economy is sharing with the rest of America in the structural transition to greater dependence on service employment. Most job growth in nonmetro areas since the late 1960's has been in the service sector, and service industries now employ more nonmetro workers than goods-producing industries.

That trend has been accelerating. Since 1969, 83 percent of all new non-farm wage and salary jobs created in nonmetro areas were in services; since 1979, more jobs were created in services than were lost in manufacturing and resource-based industries. But service-sector job growth has been slower in nonmetro areas than in metro, especially in those components that serve national and regional markets rather than local consumers. Thus, reliance on services to generate new jobs may not be realistic in nonmetro areas if goods-producing sectors in those counties continue to decline or stagnate.

In conjunction with higher unemployment in goods-producing industries in the rural economy, nonmetro population growth has receded to a level below that of metro areas. Nonmetropolitan growth began to slow by the end of the 1970's, and nonmetropolitan areas now are growing at a lower rate than metro. Data indicate a decline in the annualized growth rate for nonmetro areas from 13.5 per 1,000 during the 1970's to 7.4 per 1,000 in 1980-85.

In contrast, the metro rate has increased slightly from a little more than 10 per 1,000 in the 1970's to 11.5 per 1,000 during 1980-85. Although nonmetro growth slackened during 1980-84, there was no net outmigration

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until 1982-83; nonmetropolitan growth was about equal to natural increase. However, 1984 data does show a nonmetro net migration loss to metro areas of about 350,000 persons (Table 2). Accordingly, reduced nonmetro population growth of the 1980's may signal a return to the generalized decline of previous decades. Almost half of all nonmetro counties (1,160) lost population during 1983-85, compared with 460 that lost population in the 1970's. It was a similar situation of general rural economic stagnation and population decline that lead to major public policy initiatives some 25 years ago.

Given the nature of economic stress in rural America, public policy discussions about rural development need to be conditioned by three considerations:

- First, the rural economy is now such an integral part of the national and global economy that traditional sector-specific and community-specific policies are less able to deal with the problems. We cannot build rural prosperity by propping up certain sectors or firms in an effort to protect them from a highly competitive world economy. Such policies are costly—in the long-run they stifle creativity and new enterprise--and they reduce real wealth. Instead, highest priority needs to be given to macro policies to achieve the highest possible rates of overall economic growth consistent with reasonable price stability. No set of "development-oriented policies" will be able to overcome inadequate growth of aggregate demand in the U.S. and world-wide.

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Table 2.-Metropolitan-Nonmetropolitan Migration in the United States, 1980-84

Migration Stream	1983-84 (000)	1982-83 (000)	1981-82 (000)	1980-81 (000)
Metro-to-nonmetro	2,258	2,066	2,366	2,350
Nonmetro-to-metro	2,609	2,088	2,217	2,156
Net to nonmetro	-351	-22	149	194

Note: Metropolitan areas as defined in 1970.
Source: Current Population Survey Bureau of the Census
Prepared by Economic Research Service, USDA

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Education, communications, and transportation policies are also key to rural development. And income maintenance programs will determine the well-being of many rural poor. Rural interests are not likely to be paramount in shaping these policies; but care is needed to assure that rural areas are not inadvertently disadvantaged by such policies.

- Second, rural areas are diverse; economic stress is not the experience for all rural counties in the 1980's. Adjustments are concentrated in the agriculture, mining, and manufacturing-dependent counties--plus in the persistent poverty counties, which have always been both outside the mainstream of economic development and largely unaffected by previous programs of regional development. Thus, careful targeting of the limited funds available for rural economic development is essential.

Furthermore, growth patterns in the U.S. economy generally do not appear likely to favor large increases in the share of goods-producing employment. Thus, there is little reason to believe that the expansion or location of manufacturing enterprises in rural areas will play a major role in solving existing economic stress. This raises serious questions about the appropriateness of national policies that finance traditional kinds of goods-producing, industry-serving infrastructure and promote programs of local "smoke-stack chasing."

There is some evidence that the recent decline in the dollar is stimulating exports of manufactured goods. However, the

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long-term effects on the rural economy are unclear. On the one hand, rural manufacturing, particularly in the South, tends to be in nondurable goods such as textiles and apparel. The primary competition for these industries comes not from Japan or Western Europe but from Taiwan, Korea and other countries whose currencies are tied to the value of the dollar. Thus, rural employment in these industries may be stimulated very little by the decline in the dollar. Agriculture faces a similar situation with respect to grain exports. The dollar has depreciated little against the currencies of many importers and has appreciated against currencies of major export competitors.

Yet, to the extent that improved demand for the output of the more urban-based manufacturers stimulates plant investment, some parts of the rural economy may gain if manufacturers again shift production out of urban settings into rural areas as they did during the 1960's and 1970's. But many factors that led to rural manufacturing employment gains in that period may have changed.

Programs need to reflect realistic expectations about the potential futures of individual rural areas--their place in economic space, and the degree of urbanization of their region. These programs need to accommodate futures of stability or decline, not just growth. The role of State government has been substantially enhanced by the difficulty of addressing this diversity of rural conditions with national policies and programs.

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- Third, most of the burden of the economic adjustments occurring in rural America falls on the human resources—displaced industrial workers, displaced farmers and other proprietors, and members of their households. Problems of job loss are made worse by difficulties individual workers face in shifting from production jobs to white collar jobs in the service sector. Skills gained in farming, mining and blue-collar manufacturing employment frequently are of little direct use in the services sector. Also, pay scales are substantially lower in many parts of the services sector. Those who succeed in making the transition may have to accept changes in lifestyle as well as changes in job tasks andsome may have to move their residences to find new jobs.

  Rural workers, particularly in agriculture, are more likely to have been self-employed—often in an enterprise which spans several generations—which may also make occupational shifts more difficult. Thus, human resource policies are critical to successful amelioration of current rural economic stress.

Thank you, Mr. Chairman, I will be glad to respond to any questions you may have.

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Questions and answers, Senator Pressler to Mr. Deavers

Senator PRESSLER:

1) There has been a great deal of press attention recently on the agricultural economy. In your view do you feel that the press has depicted the problem as it really is? Do you feel the press attention has helped Americans living in more urban areas to better understand the drastic nature of the situation?

Mr. DEAVERS:

The press coverage I have seen of problems in the agricultural economy has been uneven. Overall, I think the newspaper and other print media have done the best job in reporting the economic stress being experienced by many farmers, their families, and farm-dependent rural communities. And, as a result of this media attention I believe there is now more awareness in urban areas of the serious nature of farm financial stress. At the same time, I do not believe that there is much understanding of the complex set of factors that caused the current problems, or of the complexity of solving those problems in an efficient and equitable way.

Unfortunately, the media have not done nearly as good a job of informing people about widespread structural economic adjustments affecting the manufacturing and mining and energy sectors of the rural economy. As a result, many people think that rural economic stress is principally a result of our agricultural problems, when in fact that is only one of the causes.

Senator PRESSLER:

2) Many small business owners in the smaller communities of South Dakota have indicated to me that their sales were down 40 to 50 percent. Based on your knowledge of this situation, would you say that all rural areas of the country have been affected in a similar fashion? If these low sales continue, how long do you think these businesses can survive?

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Mr. Deavers:

As I indicated in my testimony, the performance of the rural economy has been very uneven in the 1980's. The stresses of structural economic--change slow job growth, high unemployment, and poverty--have been concentrated in nonmetro counties dependent on manufacturing, agriculture, mining and energy. Thus, problems of small business owners like those you describe are probably typical of communities in these counties, but not all rural areas of the country. Even where these problems exist there is really no way of knowing how long the individual small businesses can or will survive. There are many strategies that firms use to get through hard times--but, the longer the difficult times go on, the less effective these strategies will be in assuring survival.

Senator Pressler:

3) If the agricultural economy remains pretty much as is, will the loss of main street businesses continue at the current pace?

Mr. Deavers:

Financial stress in farming clearly has impacts on the local community, but the impacts vary enormously depending on the buying patterns of farmers for both their business and household needs, and the amount of financial stress among local farmers. Thus, mainstreet businesses in farming communities will face different business prospects in different communities--none of prospects very bright, but with great variation. At some point soon, it appears that the large equity losses resulting from falling farmland values will end, and that financially stressed farmers will have left the sector or successfully restructured their businesses. When that occurs the pace of mainstreet business losses should decline significantly.

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Senator Pressler:

4) Won't the depressed economy in small rural communities soon begin to affect larger communities and eventually the entire rural economy?

Mr. Deavers:

Large parts of the rural economy are already under stress. More than one-half of all nonmetro people live in counties dependent on agriculture, manufacturing, mining and energy industries. As indicated in my testimony, many of these counties now have average unemployment rates of over 9 percent. This represents the cumulative effects of several years of poor performance by these rural economies.

Pressler:

5) In conversations I have had with small business owners in South Dakota, several said they had experienced large losses due to farmers filing bankruptcy. In your view, is this a nationwide problem? Does this problem affect a significant number of small businesses? Is this trend increasing?

Mr. Deavers:

Unfortunately, Senator, I do not know of any national data that would allow a precise answer to your questions. We do know, largely from anecdotal evidence, that farm bankruptcies often leave unpaid debts. While most of the attention has been paid to banks and financial institutions, other rural business, e.g., suppliers of seed, fertilizer, and other inputs, may also experience losses. There is no way to assess how significant are the effects on small businesses or whether the trend is increasing.

Senator Pressler:

6) If you had only one choice, what would be the single best thing the SBA or any other governmental agency could do to aid small businesses and communities that have been hard it by the farm problem?

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Mr. Deavers:

I do not have the expertise to comment about changes in the SBA program. I would repeat what I said in my testimony about the importance of overall macro and fiscal policies. There is simply no program specific action that can substitute for more rapid real growth in the U.S. and world economy. To achieve this requires leadership from the Congress and Executive Branch.

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Senator BAUCUS. Thank you very much, Mr. Deavers.

Mr. Choate, why do you not proceed, and then we will ask questions of both of you.

STATEMENT OF PAT CHOATE, DIRECTOR OF POLICY ANALYSIS, TRW INC.

Mr. CHOATE. Mr. Chairman, with your permission I will submit my statement for the record.

Senator BAUCUS. Without objection.

Mr. CHOATE. There are two or three basic points I would like to highlight from my testimony, then elaborate on some other thoughts that Mr. Deavers advanced.

First, I think it important to recognize that our rural economies by and large are fragile. Thus, policies that are important to the nation to improve our competitiveness, our ability to produce goods and services, are particularly vital to our rural communities. Over the past 40 years a basic economic shift has occurred in thousands of small communities, a shift in which those economies have become increasingly dependent upon the location of one or two or three manufacturing facilities.

The second point that I would make is, while a better, more thoughtful set of macroeconomic policies is vital and essential to enabling rural communities to face a more prosperous future, in themselves such policies are insufficient. There are a series of microeconomic interventions that are going to be required.

The third point that I would make is that service and retail activities for a major share of the employment growth that Mr. Deavers and Mr. Swain have pointed out. But when one goes back and takes a look, what one also sees is that a significant part of that growth has been built around a manufacturing base in these small communities.

It is those jobs in manufacturing, the value added that that production has created, that has made possible the growth in much of the service and the retail industry. Thus, to a very real sense saving those manufacturing jobs, strengthening those firms, becomes very important to the long term vitality of those rural communities and their economies.

The point was made by Mr. Swain in his presentation that in the period 1976 through 1984 there were about 270,000 new jobs created in manufacturing in rural areas. What was equally significant was his point that about 70 percent of those jobs were created by small firms and 30 percent by large business.

What that suggests to me is that rural communities have a very real vested interest in seeing both large and small manufacturing facilities in this country regain their vitality, and that vitality I think now is at risk.

In my testimony I point to a couple of basic actions that I think are essential to regain that vitality. The first is for American manufacturing firms, both large and small, to increase automation of their production facilities. And the reason for this is summarized by an experience of the Yamazaki Machinery Works in Japan.

I would just like to point out what is happening with our competitors. In 1983, Yamazaki's plant was already one of the world's

most advanced machine tool factories. With less than one-tenth of the 3,000 workers needed in a comparable facility—in a facility in the United States for example—that plant could already turn out a compact, numerically controlled lathe in two weeks, compared with three to four months for American competitors.

Using the new flexible system the company introduced in 1983, however, that plant can now meet its previous output with one-fifth of the personnel—that is 39 employees, compared with 195 using its old systems—less than half the equipment previously used, only two-fifths of the floor space, and one-third the process time.

Now, that is the type of competition that rural firms, both large and small, are going to have to face. One of the reasons that foreign competitors in Japan, for example, are able to automate so readily is because that nation has put into place public policies that support such activities.

Specifically, the Japanese give their small firms a 53 percent first-year tax deduction for robotics investment. They have a national leasing company to lease automation equipment to companies, thus reducing their initial capital costs. And they offer special long-term 2 and 3 percent loans to small- and medium-size firms to help them get right to the cutting edge. That is important.

Plus, they support the Japanese Robotics Institute, which goes out and gathers the best technology in the world and brings it back. Indeed, what the Japanese have done is set up the equivalent of a county agent system for automation, to give people the technical assistance they need to get to the cutting edge of technology.

Moreover, the Japanese government now spends a quarter of a billion dollars a year on automation research. The latest numbers I have for the United States were for 1985, when we were spending about $50 million a year, and $40 million of that was for military automation, not for the type of automation that small manufacturers need.

The second question and a second major issue that these small manufacturers face is how do they get the long-term money they need to make the investments? Now, for big business, the primary problem is not one of getting the money; the problem is that the money they get demands that they act short term, seeking quick results and short term earnings.

For the small firms, they simply cannot get the long term money. Indeed, research that I have seen suggests that 85 percent of the loans of a million dollars and less to these small firms have a due date of 5 months. You cannot think long term with 5 month money.

What I am suggesting is that perhaps we need to take a look at the creation of some new devices based upon secondary markets, to find some ways and means that permit our major capital institutions, our pension funds, our banks, and other financial mechanisms to channel billions of dollars into the small business sector through the creation of a new secondary market.

So in sum, what I am saying is that many things need to be done to improve the vitality of small business. A big part of that is macro policy, but there are dozens of other micro policies such as

the two that I am suggesting here this morning that really do merit serious consideration.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Choate follows:]

Statement

of

Pat Choate
Director of Policy Analysis
TRW Inc.

Before

The SubCommittee on the Rural Economy and Family Farming
The Senate Small Business Committee

United States Senate
One-Hundredth Congress
March 5, 1987
Washington, D.C.

Mr. Chairman and Members of the Committee:

I am honored to have this opportunity to share with you some thoughts on the state of America's rural economy. And in fairness to you and my employer, TRW Inc., I emphasize that the views I offer do not necessarily represent any position other than my own.

Trouble in Rural America

As other witnesses will document, the economies of rural America are heavily dependent on manufacturing employment. Indeed, the jobs and prosperity of thousands of small communities across America depend on the fate of one, two, or, at most, a handful of small and medium sized manufacturing facilities.

And this is risky because U.S. industry is losing position in the world marketplace. These losses are occurring across the economic spectrum in the basic, high-tech, service and agricultural sectors.

Reversing this economic decline requires special attention to the competitiveness of the national economy. This, in turn, requires major shifts in trade, fiscal, monetary, and exchange rate

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policies. At the same time, there are a number of other microeconomic policy shifts that are vital to the creation of a more competitive small business sector, a key element in any longer-term effort to strenghthening our nation's rural economy.

The most important of these are actions that can: (a) speed the robotization of American industry, large and small; and (b) increase the flow of long-term capital to small businesses.

The Automation Factor

If American manufacturing operations, large and small, are to regain their competitiveness, they must have the cost savings, flexibility, and qualitative improvements that automation makes possible.

Yet, American manufacturers have been markedly slower in introducing automation technologies than have their competitors abroad. In 1980, for example, the United States possessed 15 percent of the world's robots. Because of the lagging pace of U.S. automation and the accelerating pace of automation abroad, America will possess less than 10 percent of the world's robots by 1990. Today, Japan has more than three times as many robots in operation as does the United States.

The effects that automation can have on a firm's competitiveness are illustrated by the experiences of Japan's Yamazaki Machinery Works. In 1983, Yamazaki's Minokamo plant was already one of the world's most advanced machine tool factories. With less than one-tenth of the nearly 3,000 workers needed in comparable conventional facilities, the plant could turn out a compact numerically controlled lathe in two weeks, compared with three to four months for Yamazaki s overseas competitors.

Using the new flexible system, however, the Minokamo plant can now match its previous output with one-fifth the personnel (39 employees compared with 195 using the old system), less than half the equipment (43 pieces compared with 90), two-fifths of the floor space (6,600 square meters compared with 16,500), and one-third the process time (30 days compared with 91). The plant requires no drawings, moreover, because the new system is connected to the CAD/CAM Center at Yamazaki headquarters nearby.

Yamazaki's experiences reflect that Japan, of all nations, has been most aggressive in fashioning a long-term infrastructure of automation. The Japanese government is financing a multi-hundred million dollar long-term research effort on automation; it

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permits a 53 percent first-year tax deduction for robotics investment; it has formed a national leasing company to lease automation equipment to companies, thus reducing initial capital costs; and it offers small and medium-sized firms special low-interest loans for robotization.

The Japanese government also provides financing for the Japan Industrial Robot Association, which conducts research on robot marketing and application techniques and monitors global technological developments and patents, which are translated into Japanese and distributed.

By contrast, the U.S. government does not monitor the automation efforts of other nations, offers no technical assistance to firms, provides no special incentives for firms -- small or large -- to automate, and funds little nonmilitary research on automation.

Long-Term Capital

For both small firms and large corporations, quick results and short-term earnings have become their obsessive goal. By ceding the future to the present, American business has greatly reduced its capacity to cope with foreign competitors whose actions are shaped by long-term perspectives. Indeed, it is the short view of American business, more than anything else, that threatens the long-term vitality of the economy.

For big business, the primary source of this short-term myopia is the unrelenting pressure of financial institutions -- pension funds, insurance companies, foundations, investment companies, educational endowments, trust funds, and banks -- for quick results and high quarterly earnings. For small business, the primary source of these short-term pressures is their inability to secure long-term debt financing.

The key action to reduce the short-term pressures on big firms is to place a stiff tax on the short-term speculative gains of the tax-free trades of financial institutions.

If small business is to get the long-term debt financing it requires, new mechanisms are required that can help infuse more long-term affordable capital. The model that best demonstrates how to provide these monies is the secondary market for residential mortgages.

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Prior to World War II, banks and savings and loans were unable to tie up their capital and deposits in long-term mortgages because there was no secondary market in which they could sell a mortgage should they require liquidity. Banks or insurance companies in New York, Chicago, Los Angeles, Dallas, or Atlanta, for example, were uninterested in buying a mortgage on a house in rural Oklahoma, Arkansas, or Montana. The individual transaction was too small, and the bank would have difficulty servicing the debt (collecting payments, ensuring payment of taxes, etc.) or arranging a resale if the homeowner defaulted.

Before the major financial institutions could channel significant long-term investment into housing, mechanisms were needed to overcome these problems. Since the costs and risks of starting such a mechanism were too great for private investors, government action was required. Responding to this need, the government established the Federal Home Mortgage Corporation, The Federal National Mortgage Association, and the Government National Mortgage Association.

These mechanisms have helped create a secondary market in housing mortgages. They do so by purchasing mortgages from banks, savings and loans, and other financial institutions, bundling many small mortgages into a large mortgage-backed security, and then selling that new security to banks, pension funds, businesses, and individuals. In turn, these new financial instruments are traded, much like corporate or government bonds. The savings institution or bank that originates the mortgage recoups 90 to 100 percent of the loan funds, money which can then be reinvested. The local financial institution also receives a fee to service the individual mortgage it sold.

The broad secondary market in housing mortgages has created a safe, convenient means for financial institutions to channel hundreds of billions of dollars into long-term housing mortgages. The availability of these funds has made possible long-term mortgages, low down payments, and dozens of other innovations. As a consequence, the housing industry has been revolutionized and two-thirds of Americans now live in their own homes.

As with housing a half-century ago, the secondary market for small business loans is limited now. Insurance companies, pension funds, large banks, and wealthy individual investors are unwilling, for understandable reasons, to buy a small business's loan from a bank. The transaction costs are high relative to potential profits. The major financial institutions have little or no knowledge of the firm or its executives. Before major

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financial institutions will channel their funds into long-term small business financing, they require a mechanism that can package many small business loans into a broadly backed, large security that can be bought and sold with ease.

A device to stimulate the secondary market in industrial mortgages has been conceptualized by economist Michael Kieschnick and offered as legislation by Congressmen Charles Schumer and John La Falce. This device, called a Federal Industrial Mortgage Corporation (FIMC), would acquire a portion of individual small business loans from local banks and package them into a larger security that could be sold and traded. The bank that originated the loan would be paid to service it, and would also recoup part of its funds for reinvestment. Since the local banks would hold 30 to 40 percent of the loan, and thus would share any losses, they would likely be prudent. Enabling banks to make standardized long-term loans of five, ten, and even fifteen years to small businesses would reduce many of the short-term financial pressures that these firms face today.

Most significantly, the FIMC would provide pension funds, insurance companies, and other large institutional investors with a safe, convenient vehicle to channel billions of dollars into long-term loans for small business. These funds would enable the most dynamic sector of the U.S. economy to take a longer-term view, prosper, and in the process, increase the flexibility required for American entrepreneurs to innovate, compete and generate jobs.

The FIMC would be of special benefit to small communities, because they are so dependent on small businesses.

Conclusion

While improving in U.S. economic competitiveness is important to the entire nation, it is particularly important to rural communities. Their economies are far less diversified than those of urban areas, and much more dependent on manufacturing.

Reversing recent declines in U.S. competitiveness will require many actions -- macroeconomic and microeconomic -- taken over many years by all segments of our society. But among the most important of these are those that will enable firms in small communities to invest in state-of-the-art automation and technology. If that is to be, ways and means are needed to provide long-term money.

Thank you and I look forward to your questions.

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Senator BAUCUS. Thank you very much, both of you.

Mr. Deavers, what about an overhaul of the county extension system here? That is not primarily your responsibility, I know, but you are related to it.

Mr. DEAVERS. I really cannot comment on overhauling the system. What I can say is that parts of the extension system have done an extraordinarily effective job in reaching, for example, some of the displaced farmer families. I am familiar with a program in Nebraska which, using JTPA funds, has become a model of what can be done in terms of providing counseling, providing training, that makes it possible for families that have decided to leave the farm because of financial reasons to make a successful transition to the non-farm sector.

I think there are models in the extension program that show that that network can in fact reach the kind of problems we are seeing in rural America. But I am not really in a position to talk, sir, about overall reform of the system.

Senator BAUCUS. I was wondering. Mr. Choate, you mentioned the idea. I think it is an excellent idea. I wonder if you have given any more thought to it?

Mr. CHOATE. Well, I have spent about half my career working on rural development activities in Tennessee, Oklahoma, and Appalachia. And one of the things that I always found was that the county agent system was extraordinarily effective.

The county agents understand the leadership structure in those communities. They are well trusted by people within the community. They simply understand what is going on.

It seems to me that it might well be beneficial to find some modified roles for the county agent system, whether through an appended system or some changes in the existing system, to build on the strengths that are already there, to help small businesses make some of these adjustments, not only in the introduction of automation technology, but to better understand global markets and what is required.

Senator BAUCUS. I am sorry, Mr. Deavers. You said you were already aware of some county extension agents or programs that are moving in this direction. Where are they now?

Mr. DEAVERS. One of the model programs is in Nebraska, and it has used federal funds provided out of the Secretary of Labor's Office under authority of the JTPA program. There are other programs.

Dr. Pulver, who will be testifying on a series of Wisconsin programs will have other examples of what extension has been able to do both to help farm families as well as to help communities that are facing serious economic adjustments.

So there is a capacity within that system. There are some models in that system which I think can be generalized and used more broadly.

Mr. CHOATE. May I add one other comment that might merit exploration. The Department of Commerce operates a commercial service overseas. I know the Department of Agriculture has been very good on agricultural sales. It might be worth exploring whether there is a need to better tie up the non-agricultural activities of the Department of Commerce with the county agent system, again

into an expanded program to assist medium- and small-sized manufacturers.

Senator BAUCUS. I would like to explore a little more the implication that I think you are making, Mr. Deavers, that the growth in the greater number of jobs in rural areas are in services as opposed to, say, manufacturing.

I think in some of the literature and commentators, historically anyway, are implying that it is not all that bad. It is my view that it is bad. Sure, the United States, to some degree, will have expanded services because to some degree we have the income. Although that is changing now.

On the other hand, it is my very strong opinion that the strength of the services really depends upon the strength of manufacturing.

This country can not allow itself to be trapped into the viewpoint that it is okay for America to move a little away from the manufacturing based economy to a service economy. I think that is a trap. I think we will find ourselves more and more trouble down if that is the case.

In fact, I think that the chances of manufacturing firms, large or small, in rural America will grow to the degree that the country helps to encourage manufacturing. One will spawn the other.

Financial services also follows manufacturing. If we lose manufacturing, we will lose the financial services. In fact, that is happening. Tokyo is becoming much more the financial capital of the world than was the case years ago.

It was not so long ago that Great Britain thought it could lose its manufacturing base and still be the world's financial center. What happened? It lost it. Why? Because the financial institutions go to where the manufacturing is. They came to America. New York became the largest financial center in the world.

But is slipping. Now they are going to Japan because of the growth in manufacturing.

So I encourage all of us to work very hard to build a manufacturing base generally and targeting rural areas.

Mr. Choate, you made an excellent point, that is, the problems of finding long term capital, is a problem for rural areas. You mentioned perhaps a secondary market program or a pool.

Could you please talk a little more about that.

Mr. CHOATE. The Small Business Administration has operated a small secondary mortgage program for several years. The most recent GAO study I have seen of that program I believe was done in 1984. And what intrigued me about that study was that I think somewhere in the neighborhood of 70 percent of those moneys came from first term loans from SBA.

One of the things that this indicated is that you have a series of businesses that get started, that get the initial venture capital and really get going. But to go to the next stage of expansion, they really needed some 5 and 10 and 15 year money. And the data put—that was put out by the General Accounting Office indicated that that seems to work very well.

Beyond SBA loans, though, most firms do not have access to that sort of a mechanism. And more importantly, in small communities such as May Pearl, Texas, where I grew up, or in small towns in Montana, small firms seeking 10-year money find that it is virtual-

ly impossible to obtain that money outside of a New York financial center or a pension fund.

And even if they could make a contact, the transaction costs would be so high that it just would not pay that financial institution to make available a small amount of money rather than the large amount that a big corporation like TRW, for example, might request.

But it seems to me that in the industrial mortgages, much has occurred in this country in the thirties with housing markets, that there is a way that we can use our banks and others as a retail network, permit them to sell part of that paper to a central mechanism that could be created by the Federal Government, and then maybe some day be privatized; that they could then bundle up lots of $50,000, $100,000, and $200,000 loans, put them into a $50 or $100 million instrument, and then go to the pension funds and others, where it gets to be attractive and where it is convenient to those institutions.

I think that would be very useful. I think it would be useful, among other reasons, because it would provide those financial institutions, which have billions of dollars, a safe, convenient, easy instrument and mechanism by which they could then begin to channel billions of dollars to our small businesses in both urban and rural areas.

In my own view, that is going to be essential, not only to the economy but to both the rural and urban areas for the simple reason that our small businesses are creating about 70 percent of our jobs. That is true nationally and the data presented earlier by the other speakers indicate that it is true there.

So what we really need if we are going to capture that vitality, we need to find the ways and means to channel that long term money.

Now, in my own mind's eye, this is a role that only the federal government can fill to in effect prime that mechanism, to get it to kickstart, to get it going. It was necessary in the housing markets, and because we did it as a country in the housing markets, most Americans now have access to long term mortgage money.

I am suggesting that, for the same reason, we need it for small business.

Senator BAUCUS. I think that is a good point. A few years ago, analysts were saying: My gosh, look at Japan; they have got their MITI, and so forth, and they plan a little bit more; why should not America plan. And all that concern raises hackles over here, justifiably, I might add.

But the fact is we really have had two industrial policies in this country. One is housing with HUD and FHA and the deductibility of mortgage interest, and so forth.

And the second, to some degree, has been agriculture with REA and the farm program. Frankly, as important as it is to have adequate housing and strong agriculture, we also have to pay more attention to the kinds of technological development and pools of capital to help spur some technology development.

I am not talking about just high-tech. It is high-tech and mid-tech and low-tech. We are into a technological revolution and we

have to develop some kind of a national policy that pays much more attention to that.

Mr. CHOATE. And I would go one point further on this and say that much of the capital we need to do what we are talking about already exists. It is found in our pension funds and institutions and other organizations. But what we do not have is a channel or a mechanism or a device to make that connection between our small businesses and that capital mechanism.

And we need some way to open that up. And so I think a secondary mortgage mechanism here can really do it, and I think it would benefit this country enormously.

Senator BAUCUS. That is an excellent point. I know it is a big problem in my state of Montana. It is very difficult to get the capital. I hear it all the time, and nobody yet has come up with a surefire solution. Many are working on it, but it is a very significant problem.

One final question. Mr. Deavers, have you given any thought to the effects of deregulation in the transportation or banking industries on rural small towns? Have you had any chance to analyze that at all?

Mr. DEAVERS. We have been doing some research on that, Mr. Chairman. What I would say is that the evaluation is not complete and the effects of deregulation in terms of their relative impact on rural communities versus the country as a whole differ probably by what sector you are talking about that has been deregulated.

In the transportation area, for example, it appears in terms of airline deregulation that many small rural communities now have more frequent, but higher cost, service than they had before. And the question is is that better or worse service?

It is clearly more accessible to some people who can afford to pay for it, but it is also a situation where it is not the same kind of service that those communities had become accustomed to when a portion of their service costs were subsidized.

In the banking area, there is some evidence, I think, to suggest that the spread of relationships among city center and financial center banks and smaller rural institutions does two things. It makes possible a wider range of investment opportunities for those rural banks, and it can give, if you can figure out some way to deal with the transaction costs for the city center banks, as Dr. Choate was talking about, it can in fact pool resources to bring larger loans, larger pools of capital, back into rural communities.

If you look at the behavior of banks in terms of their portfolios, what matters is not whether they are rural or urban. What matters is their size. Rural banks by their very nature are small banks, and they therefore have different behavior in terms of the portfolio choices they make simply because of their scale. They are more risk averse.

If we can figure out a way of making use of the financial center banks' capabilities and channeling those capabilities to investment opportunities in rural places, I think that that can in fact have a substantial potential. And deregulation I think can facilitate that, but it will not make it happen in and of itself.

In communications, what I would say is that the jury in communications is really out, the reason being that the communications

infrastructure in many rural communities is not very modern. There has been a lot of talk about how an information economy frees people from being employed in large places where they are in close communication with others, because telephonic communication then becomes a substitute for being physically close to the person.

Well, that assumes a number of things about the quality of the communications infrastructure that is available. You cannot, for example, have an information based rural economy with multi-party lines and the absence of digital switching. And if you go to small rural communities in many parts of this country, what you find still is no digital switching networks and multi-party lines.

That by itself will mean that many rural communities will not be able to compete in the kind of job generation in the information industry that many people have assumed would make them better competitors.

So I think there are some serious issues in terms of the adequacy of the rural infrastructure in the telecommunications area, sir.

Senator BAUCUS. I appreciate it. That is a very interesting statement.

Could you explain to me, as a non-expert in communications, what digital switching is?

Mr. DEAVERS. No. I am at the same point. There is a researcher at the University of Washington who has been pointing out to me the need for digital switching, and I have asked him the same question and the language he gave me in response was an engineer's response. And I will not try to repeat it for you, sir.

We can try to provide something for the record.

Senator BAUCUS. Dr. Choate, do you know?

Mr. CHOATE. I know less than Dr. Deavers.

Senator BAUCUS. I hear that all the time. For example, Memphis, Tennessee, has more WATS lines on a per capita basis—I may be wrong on this—than any other community in the country because it has a much more sophisticated telephone system, including digital switching, and it is a way to generate more businesses for Memphis.

I heard someone else make the same point that you were making. That is, if a part of the country, particularly a rural area, wants to grow, it has to put the bee on its telephone companies to make sure that it converts to digital switching.

I notice that the Senator from Iowa is here. Senator Harkin, any statement?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator HARKIN. Mr. Chairman, I do not have a statement. I apologize for being here late. I am interested in the subject of the hearings today. I was just catching up on reading some of the testimony of the first few witnesses here.

I wondered if I just might, Mr. Chairman, have a minute to make one brief observation and ask Mr. Choate—is it "Coat"?

Mr. CHOATE. "Chote."

Senator HARKIN. Mr. Choate a question. You caught my eye when you started talking about the automation factor, and you mentioned this Japanese plant, the Yamazaki Machinery Works. I am not familiar with that particular one, but I am familiar with some of the other ones in Japan and what they have done with automation, having been there a number of times myself.

You said in your testimony that American manufacturers have been markedly slower in introducing automation technology than have their competitors abroad. And then in your last paragraph, you said, by contrast, the U.S. Government does not monitor the automation efforts of other nations, offers no technical assistance to firms, provides no special incentives for firms, small or large, to automate, and funds little non-military research on automation.

I think there is perhaps one other thing that you forgot to mention. You see, the Japanese Government has a policy that no one in Japan will ever lose a job because of automation. No Japanese individual will lose a job because of automation.

If automation replaces that person, that person will be retrained and replaced on another job of equal pay. Right away then, you have got a built-in support for automation. You have got all the workers out there.

And that is sort of the problem we have in this country. Obviously there is a threat to automation for people who have to feed and clothe their families and pay their mortgages and everything else, and provide for their families. And so I daresay that if our government had such a policy, I think you would find automation would be more readily adapted in this country.

And that is just one thing that I happened to find out in Japan. I was wondering how they could automate all these things and they did not have worker uprisings. Well, that is why.

Mr. CHOATE. May I just make a comment on that? There have been some surveys done by Daniel Yankelovich that I find to be just fascinating along the lines of your comments. What they find is that about 70-plus percent of the American work force is very enthusiastic about technology. They think it has improved their lives, they think it has improved their work.

Senator HARKIN. It has made their jobs easier.

Mr. CHOATE. It has made their jobs easier, ended the three H's of work—hot, heavy, and hazardous. Only about 25 percent, 30 percent, are worried that technology is going to throw them out of a job.

And of course, they are wrong. I mean, the fact of the matter is we are losing about two million jobs a year that disappear because the jobs disappear. I mean, they are gone. People become out of work because the jobs disappear.

I could not agree with you more. The country really does require a comprehensive, efficient dislocated worker program. We need to go back and make the employment service really work.

I mean, here is something that is within commuting distance of every worker in America, 2,400 local offices. It only touches about 7 percent of the American population and gives counseling to about 3 percent, testing to about 2 percent.

Our training programs do not assist these people. There is going to be a relocation need. We do not have that. I think the Japanese

are very wise in some policies that we should emulate. What they are in effect saying to their small businesses: to compete in the jobs of the future, you have got to have the quality and the savings and the productivity that automation makes. And it is a national policy to automate their small businesses.

And I think you are exactly right, at the same time you have got to have a dislocated worker program to deal with it. Now, if you can have the automation you can get the productivity that is necessary to create the service jobs, because they are linked.

You can create enough new jobs, but if you do not have the automation you are going to lose it all. If you do not have the dislocated worker programs, you are not going to have the support to help people make these transitions.

Senator HARKIN. I appreciate that. I was on a line one time in Japan and I asked, I just asked. I said: What happened to all the people? These robots—I saw this whole assembly line with nothing but robots. I said: What happened to all those people that the robots replaced?

And they said: Well, some of them are making robots. You know, that is not a bad deal. It is that kind of a thing, you see.

So I appreciate that. I know it is a little bit off the subject of rural areas and stuff. And I of course, like I am sure my colleague from Montana, am very concerned about what is happening to our rural areas. I am sure Montana is not a heck of a lot different than Iowa in what is happening to some of our small towns and our communities, losing our small banks.

Both of you, I think, mentioned in your testimony, I know Mr. Deavers did, about manufacturing now sort of replacing agriculture in many of our rural counties throughout the United States. And you said manufacturing, but is it not also very heavily service-oriented, too? I am sorry. If you have already talked about this, I apologize, Mr. Chairman. There was one point I kind of wanted to grab a hold of here.

Mr. DEAVERS. Actually, the transition in rural economies from a principal dependence on natural resource industries, including agriculture, began post-World War II and happened most rapidly in the fifties and sixties. So that by the time we entered the seventies, most of our rural citizens worked either in manufacturing or in service industries.

And now the combination of agriculture, manufacturing, mining and energy provide about 35 percent of the jobs in rural America. About 60 percent of the jobs—60 percent of the jobs of rural America are provided by services.

The service economy is—let me go back to the point the Chairman made a moment ago. You cannot have some kinds of service jobs without a manufacturing base. What has clearly been happening in the eighties in rural areas is that in the rural communities where agriculture is in trouble, where manufacturing is in trouble, where mining and energy are in trouble, even the service sector is not growing very rapidly.

In the rest of rural America where we do not have those kind of structural adjustments occurring, most of the job growth is in services and that job growth is fairly rapid. But you cannot have a continual deterioration of the goods producing sector and have rapid

service growth at the same time. This decade has demonstrated quite dramatically that that is true.

Mr. CHOATE. If I might, I would extend that comment to say that as a country we need to make two basic distinctions. One is between industrial production and industrial employment.

We need the industrial production because it provides a base for the balance of the economy, or part of the balance of the economy. But the only way that we can get that industrial production is to have less industrial employment, rural and urban. It means we have got to go the automation route.

The second basic distinction that we need to make is between manufacturing and service sectors of the economy. Manufacturing produces about 30 percent of the value added of our economy. That value added is the firm foundation for the other 70 or a good portion of the other 70 percent. You lose the manufacturing base, by definition you are going to lose the linked service industries.

So what it really says to us as a country, to save the manufacturing base and the industrial production, even at the sacrifice of the industrial employment, we have got to automate, we have got to get the technology and the capital equipment in there quickly.

If we do that, we can save the service base. If we can expand the industrial production, we can expand the service side, as Mr. Deavers, Mr. Deavers, was saying. And in the process of doing that, we can create lots of good jobs, well paying jobs for people.

Then the question becomes one that you spoke to earlier, Senator, and that is how do we retool today's workers for tomorrow's jobs, and how do we do that with speed and with a minimum of disruption.

Senator HARKIN. Thank you very much. Very stimulating, Mr. Chairman.

Senator BAUCUS. Thank you very much, both of you. I wish we had more time, but we have others following you.

Our next panel will be: the Honorable Charles Cook, State Senator from New York; Dr. Glen Pulver, Department of Agricultural Economics of the University of Wisconsin, Madison; and Dr. Mark Drabenstott, Research Officer and Economist for the Federal Reserve Bank of Kansas City.

Senator Cook, would you please begin.

STATEMENT OF HON. CHARLES D. COOK, A STATE SENATOR FROM THE STATE OF NEW YORK

Senator COOK. Thank you very much, Mr. Chairman.

I want to congratulate you because I think that you are, instead of looking at the immediate present, beginning to look at the immediate future, and I think that is perhaps a very positive move that is overdue.

Just to give kind of an apologetic for how I happen to be involved in rural issues coming from a State like New York, I would indicate that my senate district contains more people than the State of Wyoming.

Senator BAUCUS. How many people is that?

Senator COOK. 300,000 plus.

And more land area than the State of Connecticut. So I have an interesting dichotomy of being in an urban State with some three million rural people, which sort of dwarfs the population of some half of the states in the Union.

The Commission on Rural Resources was created some three years ago to perform somewhat the same task that you are performing, and that is to try to rationalize the socioeconomic changes that are coming into the rural communities and to try to develop strategies at the State level that will address some of those changes that are occurring.

I will not repeat much of what I have said in my prepared remarks because I think they are repetitious of things that have been said here, except to perhaps emphasize some of the points other speakers have made; one of those points being our perception that it is important to emphasize the socio and economic interrelationships of what I said. To try to talk about economic development and not talk about sociological development is not going to do the job, and vice versa, you obviously cannot develop a social policy if you do not have a strong economic policy.

I think that another point that was made is the Nation is extremely diverse, as is our State, and therefore one of the things that you as Federal legislators could be aware of is being flexible enough in devising various Federal programs that, when State organizations such as the Office for Rural Affairs which we have just created in New York begin to try to develop programs that address the needs of rural areas, that we can indeed draw upon a number of different streams and pull them together into a coherent program.

One of our findings in the commission has been that there are restrictions on various programs coming out of the Commerce Department, the Agriculture Department, the Labor Department, where have you, that pinpoint programs; and that the regulations become sort of self-exclusive, and therefore it is not easy to meld one program with another.

Well, if you are dealing in a county with 10 or 25 or 40,000 people and you can perhaps be eligible for a small amount of assistance from Program A and another from Program B and a Program C, but you cannot put them together, you do not have the benefit or the impact; and that those Federal dollars that are available could be much better utilized if we could have that flexibility to draw these programs together.

A second factor that I think cannot be underestimated when we talk about social policy is that to talk about trying to develop the economy without developing educational alternatives for our young people is also ignoring reality. One of the initiatives which our commission has undertaken and which I know that in many other states is occurring, Iowa being one of them, is the telecommunications, interactive telecommunications.

This gives to those rural students the availability of diverse course offerings in those small rural schools that have not previously been available to them. And if you are talking about availing rural people of the possibility of economic progress and growth, you have to recognize first that there is mobility in this country, one of the opportunities that these rural people, need is, if they choose to

move into an industrial center, that they are not foreign to that environment.

And, unfortunately, with the change in technology occurring, unless we have an educational system that is really uniform throughout the country, these people can be frozen out of the future of this Nation.

There has been talk about the need to diversify the economy, and we certainly agree with that. At the same time, the point that you made, Senator Baucus, with regard to the change away from industries that are resource-based, is something that certainly occurs everywhere.

One of the proposals which our commission is currently placing before the state legislature is the creation of a rural development authority, which would have amounts of money to loan to commercial enterprises, manufacturing enterprises, or processing enterprises that would utilize indigenous natural resources, that is mineral, forestry, or agriculture, the point being that we are giving to someone else all of the value added possibilities of our natural resources.

The program that can, if you will, go back to a natural resource-based economy does two things. First, it gives a job to someone in the factory, the packaging plant, or finishing plant. Second, it provides a market for those people who choose to stay in the resource-based, the primary industry, mining or farming or forestry.

So you really create two jobs with the same dollar. We think that that is much more helpful to a rural community than perhaps trying to bring a factory in that is going to import its raw materials from elsewhere, process them, and ship them back out, because that creates one job, it does not create two jobs.

That is something which we are working on currently. Obviously, the amount of money involved is not large, but it is something that we would suggest may be a means of dealing with the immense amount of natural resources which we still have in this country.

You in your own State have wealth under the ground that is tremendous. The farming communities in this Country have a tremendous capability of producing agricultural products. What they need is to convert those resources into something that is available and useful.

And I have to think that that can be done more efficiently on the ground in the small community than it can be done by carting it off to some other location for processing. The trees that we cut in New York State—we have good hardwoods—we ship them off to Germany and they make beautiful furniture, send it back, and sell it in the stores in New York City at an immense profit, and we get perhaps ten percent of the value of that furniture in our State.

This is doubly important, because the discussion has been had with regard to technology, and indeed we do have a growing technological sector in New York State. In my own district, IBM has an immense installation and it is very important to us. That gives employment to a lot of people, but it presupposes a certain degree of technical ability on the part of those employees.

We also have a large tourist industry, but tourist industries fluctuate and to some degree they create a certain number of problems for us, because between the summer season when you can go swim-

ming and the winter season when you can ski sometimes these employees end up on the streets and become social problems for us.

What is needed are more stable jobs for the people in the middle, the less skilled worker who can find that manufacturing job that is not in a technological based industry, but the kind of traditional manufacturing job that we have had in this country.

So we think that the importance of trying to utilize those natural resources cannot be overstated.

There are some other things relative to that, that relate to the quality of life as well as to the manufacturing economy, and that is infrastructure. I think someone alluded to that. As people gather and congregate, they do create some drain on resources, in particular ground water. We, with the crunch coming into my particular part of the State, find the threat to ground water to be particularly onerous.

But the difficulty is that to these small villages with 1,000 or 2,000 or 5,000 people, a $10 million water supply system or a $10 million sewage treatment plant is a tremendous undertaking. And obviously, the need exists not only for residential purposes but for any small business or industrial development. That is something that needs to be addressed and something that perhaps we between us at the Federal and State levels could be looking at.

Also, it probably does not need to be said, but transportation is vital to the development of any kind of commercial enterprise. One of the things that our commission is proposing at the State level is the development of a priority road system.

It will be a primary road system, first for industrial purposes, secondly for commercial, and finally an access system in the local communities, in which we will highlight those arteries which are most important for, A, the industrial development of the community as a whole, and second, the availability of jobs to people, the ability, if you will, of people to get to those jobs that do exist.

At the same time, the transit portion of this is also a need. One of the problems—and you mentioned off-farm jobs. One of the problems of getting to a job off the farm is that you have to have a vehicle, and in these days of when the margin of profit is not great sometimes farmers have difficulty having more than one car.

We do not have a transit system per se. We have developed a program for county-wide transportation coordination, in which we are encouraging counties to try to take resources that are already available—and this was interesting. I was a member of a national symposium on this issue a few months ago by the conference of state governments.

There is an immense amount of money being spent in rural areas for transportation. We do not see much evidence of it, partially because, again, we tend to segment the money, we tend to earmark it for specific groups.

We think that a coordination program could help make more transportation available to more people without actually spending more money. If you are going to give access to people to the employment, you have got to provide a way for them to get there.

These are some of the suggestions, I think, that we would have. And to again summarize as to what I think is most important, it would be that in the writing of Federal regulations and Federal

legislation we be aware of not trying to target those things so narrowly that they can only be utilized in a community where they can provide a large constituency, but indeed where we can combine them together so that communities with smaller numbers of people and smaller numbers of, if you will, recipients can utilize the money as well as the larger.

Thank you.

[The prepared statement of Senator Cook follows:]

UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON THE RURAL ECONOMY AND FAMILY FARMING

SENATOR CHARLES D. COOK
NEW YORK STATE SENATE

MARCH 5, 1987

PUBLIC POLICY RELATING TO THE RURAL AREAS OF THIS NATION IS COUCHED IN NORMAN ROCKWELL IMAGES.

PARTICULARLY IN THOSE STATES WHICH ARE DOMINATED BY URBAN POPULATIONS, THE WORD "RURAL" IS THOUGHT OF AS SYNONYMOUS WITH "AGRICULTURE"; CONJURING UP IMAGES OF PICTURE POST CARD LANDSCAPES PEOPLED BY PLEASANT BUT NOT-TOO-BRIGHT REMNANTS OF THE 1930'S.

INDEED, AGRICULTURE IS THE SINGLE MOST IMPORTANT ECONOMIC AND SOCIAL INFLUENCE IN RUPAL AMERICA; AND INDEED RURAL TOWNS HAVE SUCCEEDED IN PRESERVING SOME OF THE ATMOSPHERE AND GRACE OF AN EARLIER DAY.

BUT THE FAILURE TO RECOGNIZE RURAL AMERICA AS AN ESSENTIAL PAPT OF THE NATIONAL MAINSTPEAM; OR PERHAPS AS A MAJOR TRIBUTAPY OF THAT MAINSTREAM, HAS BROUGHT ABOUT THE EVOLUTION OF GOVERNMENTAL POLICIES WHICH ALL TOO OFTEN IGNORE THE NEEDS OF SUBSTANTIAL PORTIONS OF OUP NATIONAL POPULATION.

THE CONVEPGENCE OF THE TRADITIONAL RURAL AMERICA INTO THE NATIONAL MAINSTPEAM IS A TREND THAT BEGAN SOMETIME AFTER THE END OF WORLD WAR II, AND HAS CONTINUED AT AN ACCELEPATING RATE INTO THE PRESENT DAY.

THEPE HAS EMERGED A PURAL POPULATION WHICH IS IN NEED OF THE SAME KIND OF GOVERNMENT SERVICES AS THEIR URBAN COUSINS; YET THE CONDUITS THROUGH WHICH THOSE SERVICES MUST BE DELIVERED ARE PATTERNED IN AN URBAN CONTEXT AND FUNCTION POOPLY, IF AT ALL, TO SERVE RUPAL PEOPLE.

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THERE IS A CRITICAL NEED FOR STATE AND FEDERAL POLICYMAKERS TO RECOGNIZE THIS FACT OF LIFE HERE IN THE LAST QUARTER OF THE TWENTIETH CENTURY.

THE INTERRELATIONSHIPS OF ECONOMIC, SOCIAL, AND DEMOGRAPHIC FACTORS WHICH ARE MOVING THROUGH RURAL AMERICA, MUST BE RECKONED WITH.

FOR EXAMPLE, WHILE AGRICULTURE IS AND WILL CONTINUE TO BE THE MAJOR ECONOMIC UNDERPINNING OF MOST RURAL COUNTIES, THE GROWTH OF TOURISM IS AN ECONOMIC FORCE RIVALING FARMING IN MANY AREAS. ON THE HORIZON IS THE POTENTIAL GROWTH OF INDUSTRIES BASED ON TELECOMMUNICATIONS. LOWER COST OFFICE SPACE AND THE AVAILABILITY OF COMPETENT AND DEDICATED WORKERS ARE A STRONG LURE FOR THE URBAN CORPORATE CENTER WHICH MAY STILL MAINTAIN ITS FRONT OFFICE IN THE METROPOLIS; BUT WHICH CAN, BY THE USE OF A FEW TELEPHONE CIRCUITS, RUN ITS BACK OFFICE FROM A REMOTE LOCATION IN THE COUNTRY. THE POTENTIAL INFLUX OF A NEW BREED OF WHITE COLLAR WORKERS INTO THE COUNTRYSIDE IS A POSSIBILITY THAT WE WILL DO WELL TO CONTEMPLATE.

ANOTHER TREND THAT IS ALREADY UNDERWAY IS THE GROWTH OF THE RETIREMENT-AGE POPULATION IN RURAL COUNTIES. IN MANY AREAS, PARTICULARLY THOSE CLOSER TO METROPOLITAN CENTERS, THIS POPULATION GROWTH OF RETIRED PERSONS IS NEARING BOOM PROPORTIONS.

IN SHORT, RURAL COUNTIES ARE GROWING WITH THE INFLUX OF NEW KINDS OF POPULATION. SOME OF THIS POPULATION IS A YOUNGER GROUP, NEEDING EXPANDED OPPORTUNITIES FOR EDUCATION, RECREATION, AND HOUSING. SOME ARE OLDER PERSONS, REQUIRING ADDITIONAL AND DIVERSIFIED MEDICAL AND SOCIAL SERVICES, TRANSPORTATION, AND

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COMMUNITY SUPPORT CAPABILITY. ALL OF THIS INFLUX PLACES A STRAIN ON EXISTING WATER AND SEWAGE SYSTEMS, ON SUPPLIES OF NATURAL GROUNDWATER, ON GOVERNMENTAL SERVICES, ON FIRE AND POLICE PROTECTION, ON EDUCATIONAL INSTITUTIONS; AND INDEED, CREATES A TENSION WITH THE EXISTING UNDERGIRDING OF AGRICULTURE AND OTHER PRIMARY INDUSTRIES.

CONVERSELY, ACROSS AMERICA'S GREAT RURAL MIDSECTION, POPULATION IS DECREASING IN LARGE NUMBERS OF COUNTIES. THE REMAINING POPULATION IS, ON THE AVERAGE, LESS AFFLUENT, LESS ABLE TO SUPPORT GOVERNMENT SERVICES, YET ACTUALLY MORE IN NEED OF THOSE SERVICES THAN EVER BEFORE.

EXAMPLES OF THE INADEQUACIES OF PRESENT GOVERNMENTAL POLICIES ARE MANY.

IN THE AREA OF PHYSICAL SERVICES, SUCH AS WATER AND SEWAGE SYSTEMS, THE NEED TO DEVELOP AND SUPPORT "DOWN-SIZE" SYSTEMS IS VITAL. A VILLAGE OF 1,000 PEOPLE, FACED WITH A $10,000,000 SEWER PROJECT, CONFRONTS AN IMPOSSIBLE SITUATION. THE DEVELOPMENT OF SMALL-SIZED TREATMENT PLANTS IS AN IMPORTANT PRIORITY; AND EFFLUENT STANDARDS SHOULD BE EXAMINED TO ENSURE THAT SMALL RESIDENTIAL SYSTEMS ARE NOT CONFRONTED WITH THE SAME TESTS AS THOSE WITH LARGE INDUSTRIAL CUSTOMERS. PERHAPS EVEN MORE IMPORTANTLY, RURAL COMMUNITIES SHOULD BE ASSISTED IN DEVELOPING APPROPRIATE BUILDING CODE REGULATIONS SO THAT SEWAGE CAN BE CARED FOR IN INDIVIDUAL SEPTIC SYSTEMS WITHOUT ENDANGERING VALUABLE AND DELICATE SOURCES OF GROUND WATER SUPPLIES.

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IN AREAS SUCH AS HEALTH CARE, REGULATIONS MUST BALANCE "QUALITY OF SERVICES" WITH THE EQUALLY IMPORTANT "AVAILABILITY OF SERVICES". HIGHER STANDARDS OF PROFESSIONAL COMPETENCE CAN MEAN A DIFFERENCE IN MANY CASES OF MEDICAL EMERGENCY; BUT THE TREND TOWARD CENTRALIZED MEDICAL FACILITIES HAS BROUGHT ABOUT A VIRTUAL UNAVAILABILITY OF ANY MEDICAL SERVICES AT ALL IN MANY RURAL COMMUNITIES; AND THOSE RURAL HOSPITALS WHICH DO SURVIVE STRUGGLE WITH JUSTIFYING THEIR OPERATION IN A SYSTEM WHICH FREQUENTLY BASES CERTIFICATION UPON NUMBERS OF PROCEDURES PERFORMED AND NUMBERS OF PATIENT DAYS; RATHER THAN THE OVERALL REQUIREMENT OF THE COMMUNITY TO HAVE THE SERVICE ACCESSIBLE WHEN IT IS NEEDED.

INNOVATIVE HEALTH CARE NETWORKS NEED TO BE DEVELOPED WHICH OFFER BOTH THE AVAILABILITY OF THE BEST AND LATEST MEDICAL TECHNOLOGY; AND ACCESS THAT IS WITHIN REACH OF RURAL RESIDENTS.

TRANSPORTATION POLICY IS AN UNDERLYING NEED FOR RURAL COMMUNITIES. YET TOO MANY FEDERAL AND STATE HIGHWAY PROGRAMS DISTRIBUTE FUNDS ON A TRAFFIC-COUNT SYSTEM RATHER THAN A SYSTEM BASED ON THE FUNCTIONAL NEEDS OF THE ROADS. THUS, A PARKWAY, CARRYING HUNDREDS OF THOUSANDS OF PASSENGER CARS TO AND FROM THE CITIES AND SUBURBS, IS FUNDED HANDSOMELY, EVEN THOUGH PASSENGER CARS CAUSE LITTLE DAMAGE TO ROADS. CONVERSELY, A RURAL ROAD, USED PRIMARILY BY FARM TRUCKS, SCHOOL BUSES, EMERGENCY, AND HEAVY DELIVERY VEHICLES QUALIFIES FOR VERY LITTLE REIMBURSEMENT EVEN THOUGH IT HAS VERY HEAVY MAINTENANCE COSTS.

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PUBLIC TRANSIT MONEYS ARE FREQUENTLY MADE AVAILABLE ONLY FOR SPECIALIZED, NARROWLY-TARGETED POPULATIONS. THE SMALL SUMS GENERATED FOR EACH OF THE SPECIALIZED FUNCTIONS IS TOO SMALL TO HAVE MUCH PRACTICAL VALUE. YET A COMPREHENSIVE TRANSIT APPROACH, WHICH WOULD EFFECTIVELY COMBINE THE VARIOUS REVENUE STREAMS, CAN OFFER AT LEAST A RUDIMENTARY PUBLIC PARATRANSIT SYSTEM FOR RURAL RESIDENTS.

SPECIALIZED EDUCATIONAL REQUIREMENTS PLACE A PARTICULAR BURDEN ON RURAL SCHOOLS. PROGRAMS FOR THE HANDICAPPED AND OPPORTUNITIES FOR THE GIFTED AND TALENTED CAN BE OFFERED IN URBAN DISTRICTS THROUGH CENTRALIZED PROGRAMS. RURAL SCHOOLS, SEPARATED BY HOURS OF TRAVELING TIME, MUST MEET THOSE NEEDS IN DIFFERENT WAYS. HIRING SPECIALIZED TEACHERS FOR SMALLER GROUPS OF CHILDREN, OR BUSING THOSE CHILDREN THOUSANDS OF MILES PER YEAR TO OBTAIN THE NECESSARY SERVICES, IS AN EXPENSIVE AND TIME-WASTING SYSTEM. WE NEED TO EXPLORE GREATER USE OF TELECOMMUNICATION TECHNIQUES AND COOPERATIVE VENTURES TO EXTEND EQUAL EDUCATIONAL OPPORTUNITIES TO STUDENTS IN RURAL SCHOOLS.

AGRICULTURE MUST BE PROTECTED AND STRENGTHENED. COMPETITION FOR PRIME AGRICULTURAL LAND WITH THE FORCES OF RESIDENTIAL AND COMMERCIAL DEVELOPMENT IS A CHALLENGE WHICH MUST BE MET. TO TAX A FARMER'S FIELD ON THE SAME BASIS AS THE ADJOINING SHOPPING CENTER, IS TO ANNOUNCE TO THE FARMER THAT HE HAS NO ALTERNATIVE BUT TO SELL TO THE NEXT INTERESTED BIDDER.

IN THE PROCESS, AGRICULTURE IS RETREATING OFF THE PRIME RIVER BOTTOM LAND INTO THE LESS DESIRABLE ADJACENT TERRAIN. REASONABLE POLICIES TO PRESERVE PRIME AGRICULTURAL LAND, ALONG WITH THE FARMER'S FINANCIAL CAPABILITY TO MAINTAIN THAT LAND, IS AN URGENT PRIORITY.

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ALONG WITH STRENGTHENING AGRICULTURE, THERE IS ALSO THE NEED TO DIVERSIFY THE RURAL ECONOMY. SPECIALIZED HI-TECH JOBS, OR SEASONAL EMPLOYMENT IN THE TOURIST INDUSTRY, CANNOT FULFILL THE EMPLOYMENT NEEDS OF THE LESS SKILLED AND LESS EDUCATED WORKER. ENCOURAGEMENT MUST BE OFFERED FOR INDUSTRIES, PARTICULARLY THOSE UTILIZING INDIGENOUS RAW MATERIALS. NOT ONLY MUST RURAL COMMUNITIES BE ABLE TO PROVIDE THE NECESSARY PUBLIC INFRASTRUCTURE; BUT CARE MUST BE TAKEN TO ENSURE THAT VENTURE CAPITAL IS ACCESSIBLE TO THE SMALL ENTREPRENEUR. THE TREND TOWARD STATEWIDE AND EVEN INTERSTATE BANKING INSTITUTIONS THREATENS THE AVAILABILITY OF CREDIT FOR LOCAL INVESTORS. A STRATEGY MUST BE FOUND TO ENSURE THAT THE SMALL LOCAL BORROWER IS NOT EXCLUDED FROM THE BOARD ROOMS OF THE CONGLOMERATE BANKS.

IN ALL THESE CONCERNS THE NEED IS NOT TO INVENT NEW SERVICES, BUT TO FIND A MODE OF DELIVERY WHICH IS PRACTICAL AND EFFICIENT AMONG SCATTERED RURAL POPULATIONS.

THIS CAN PROBABLY BEST BE ACCOMPLISHED IF THE MEANS ARE FOUND BY WHICH SERVICES CAN BE PROVIDED IN A COMBINED, RATHER THAN A SEGMENTED FORMAT.

RECENTLY DEVELOPED GOVERNMENTAL PROGRAMS HAVE TENDED TO AIM AT SPECIFIC TARGET GROUPS. THEY HAVE IDENTIFIED NARROWLY-DEFINED NEEDS AND PATTERNED SPECIFIC PROGRAMS TO MEET THOSE NEEDS.

IN AN URBAN SETTING, THIS MAY WORK WELL. IN A CITY OF 100,000, A PARTICULAR NEED WHICH AFFECTS 1% OF THE POPULATION WOULD INCORPORATE 1,000 PEOPLE.

IN A RURAL TOWN OF 10,000, THE SAME PROGRAM WOULD COVER ONLY 100 CLIENTS, AND MIGHT WELL BE UNFEASIBLE, PARTICULARLY IF IT REQUIRES HIGHLY QUALIFIED PROFESSIONAL ADMINISTRATION.

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THE NEED, THEREFORE, IS TO DEVELOP A GENERALIST APPROACH; ONE WHICH CAN DELIVER A VARIETY OF SERVICES TO DIFFERING PROBLEM POPULATIONS THROUGH A COMMON ADMINISTRATIVE UNIT.

ALL TOO OFTEN, RURAL PROGRAMS ATTEMPT TO DEVELOP "CATCHMENT AREAS" FOR SERVICES IN ORDER TO GARNER THE NECESSARY NUMBER OF CLIENTS. THE GEOGRAPHIC EXPANSE OF SUCH AREAS IS APT TO LEAVE SUBSTANTIAL NUMBERS OF PEOPLE ON THE FRINGES WITH ONLY MARGINAL ATTENTION. PROGRAMS OF INTEGRATED SERVICES CAN SERVE SMALLER GEOGRAPHIC AREAS, AND WHILE THEY MAY SUFFER FROM THE LACK OF A "SPECIALIST" THERE ARE SOME EXAMPLES WHERE INTERDISCIPLINARY STAFFS ACTUALLY GIVE BETTER SERVICE BECAUSE THEY HAVE A BROADER UNDERSTANDING OF THE PROBLEMS THEY CONFRONT. FURTHERMORE, THE "REGIONAL" APPROACH HAS TENDED TO CLUSTER A GROUP OF RURAL COUNTIES AROUND A CENTRAL CITY. THE RESULT HAS USUALLY BEEN THAT MOST OF THE REGION'S BENEFITS ACCRUE TO THE URBAN CORE.

DEVELOPMENT OF EFFECTIVE RURAL POLICY IS THREATENED BY CONTRADICTORY TENDENCIES ON THE PART OF DECISIONMAKERS.

ON ONE SIDE IS THE TENDENCY TO THINK OF RURAL AREAS AS FOREIGN COUNTRIES, OR AT BEST COLONIES WHICH ARE UNDER THE SAME FLAG BUT NOT REALLY PART OF THE CENTRAL SOCIETY.

ON THE OTHER EXTREME IS THE TENDENCY TO RECREATE RURAL AREAS AS "MINIATURE CITIES" AND TRY TO MOLD THEM INTO CLONES OF THE METROPOLITAN CENTERS.

NEITHER APPROACH IS ACCURATE; AND BOTH WILL BRING EQUALLY UNSATISFACTORY RESULTS.

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RURAL AMERICA IS, AND WILL CONTINUE TO BE, DISTINCT IN ITS FLAVOR, ATTITUDE, AND PACE OF LIVING. PEOPLE WHO RESIDE THERE WILL DO SO, ACCEPTING IN LARGE MEASURE THE BALANCING ATTRACTIONS AND HARDSHIPS THEY WILL ENCOUNTER.

BUT RURAL AMERICA IS NOT STATIC. IT IS NOT A THROWBACK TO THE 19TH CENTURY.

THEREFORE, POLICIES MUST BE DEVELOPED WHICH WILL RECOGNIZE AT ONCE THE UNIQUENESS OF RURAL AMERICA, ALONG WITH ITS ROLE AS AN ORGANIC AND DYNAMIC PART OF AN INTEGRATED ECONOMIC, SOCIAL, AND POLITICAL FIBER.

TO ACCOMPLISH THAT TASK EFFECTIVELY REQUIRES AN UNDERSTANDING OF WHERE WE ARE, AND WHERE WE ARE GOING.

WE NEED TO OBJECTIVELY AND METHODICALLY CATALOGUE OUR ASSETS AND POTENTIALS AND DEVELOP PROGRAMS THAT WILL UTILIZE THE POSITIVE FORCES THAT ALREADY RESIDE IN OUR MIDST.

WE NEED TO RECOGNIZE THE FORCES OF CHANGE WHICH ARE AT WORK, TO DEFINE THE PROBLEMS AND DIFFICULTIES WHICH SUCH CHANGE WILL CONTINUE TO MAKE WITHIN RURAL COMMUNITIES; AND TO DEVELOP LONG-TERM STRATEGIES TO BLUNT AND DIVERT THE NEGATIVE FORCES WHICH COULD THREATEN WHO AND WHAT WE ARE.

AND MOST IMPORTANTLY, WE NEED TO HAVE A VISION OF OURSELVES. IT NEEDS TO BE A VISION THAT CAN SORT OUT THE CONFLICTING FORCES OF GROWTH AND CHANGE; SO THAT AS WE MAKE CHOICES ALONG THE WAY; THE BUILDING BLOCKS WE SELECT WILL CONTRIBUTE TOWARD A STRONG AND ATTRACTIVE STRUCTURE WHEN THEY ARE FITTED TOGETHER.

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TO DO THIS REQUIRES CAREFUL, INFORMED GUIDANCE FROM CARING PROFESSIONALS.

BUT MORE IMPORTANTLY, IT REQUIRES A LISTENING TO THE PEOPLE WHO ARE RURAL AMERICA.

WHILE THEY MAY NOT BE AS ARTICULATE OR SUCCINCT IN DEFINING THEIR VISIONS, IT IS THE PEOPLE WHO LIVE IN RURAL COMMUNITIES WHO SEEM TO SENSE INSTINCTIVELY THE RELATIVE VALUES AND CONDITIONS FROM WHICH THOSE COMMUNITIES HAVE RISEN.

WE WILL DO WELL TO LISTEN CAREFULLY WHEN THEY SPEAK, AND TO FASHION OUR POLICIES IN WAYS THAT WILL GAIN UNDERSTANDING, ACCEPTANCE, AND SUPPORT FROM THE PEOPLE THEY AFFECT.

NONE OF THIS HAPPENS CASUALLY OR QUICKLY. IT REQUIRES ORGANIZATION, PATIENCE, AND A WILLINGNESS TO MOVE METHODICALLY THROUGH A PROCESS OF EVALUATION AND ANALYSIS.

BUT IT ALSO WILL REQUIRE, ONCE THE ANALYSIS IS COMPLETE, A PREPAREDNESS TO FORGE AHEAD WITH DECISIVE POLICY INITIATIVES FASHIONED AFTER THE COMPOSITE VISIONS WE HAVE GATHERED.

IT IS A CHALLENGING AND FASCINATING UNDERTAKING, AND ONE WITH EXCITING POTENTIAL.

RURAL AMERICA LED THIS NATION INTO THE NINETEENTH CENTURY AND AGAIN INTO THE TWENTIETH.

I HAVE A STRONG SENSE, THAT WE SHALL LEAD THE NATION INTO THE TWENTY-FIRST CENTURY AS WELL.

HOW WELL WE DO OUR JOB MAY WELL DETERMINE THE QUALITY OF LIFE FOR FUTURE GENERATIONS WHO WILL SEEK THE BEST OUR RURAL HERITAGE CAN OFFER, BUT WHO ALSO NEED AND DESERVE THE BEST THAT OUR MODERN SOCIAL AND ECONOMIC STRUCTURE CAN PROVIDE.

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Questions and answers, Senator Pressler to Senator Cook

1) THERE HAS BEEN A GREAT DEAL OF PRESS ATTENTION RECENTLY ON THE AGRICULTURAL ECONOMY. IN YOUR VIEW DO YOU FEEL THAT THE PRESS HAS DEPICTED THE PROBLEM AS IT REALLY IS?

1. Press coverage of the farm crisis has not been altogether accurate. It has necessarily focused upon the minority who are in extreme distress; and in truth, I have felt that the interviewers consciously sought out people who would support the point of view they were trying to advance.

IF NO:

WHY NOT?

DO YOU FEEL THE PRESS ATTENTION HAS HELPED AMERICANS LIVING IN MORE URBAN AREAS TO BETTER UNDERSTAND THE DRASTIC NATURE OF THE SITUATION?

Nevertheless, the press coverage has helped to alert the nation to the distress which is wide spread in the farming community and to build sensitivity and support for whatever remedial efforts may be developed. I am not sure that the press reports have done much to promote an intelligent understanding of the issues, but I think they have created a willingness for people to give support to some responsible remedial measures.

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2) MANY SMALL BUSINESS OWNERS IN THE SMALLER COMMUNITIES OF SOUTH DAKOTA HAVE INDICATED TO ME THAT THEIR SALES WERE DOWN 40 TO 50 PERCENT. BASED ON YOUR KNOWLEDGE OF THIS SITUATION, WOULD YOU SAY THAT ALL RURAL AREAS OF THE COUNTRY HAVE BEEN EFFECTED IN A SIMILAR FASHION?

IF YES:

IF THESE LOW SALES CONTINUE, HOW LONG DO YOU THINK THESE BUSINESSES CAN SURVIVE?

2. It is not possible to equate New York's small business situation totally to that of South Dakota since few of our businesses depend totally upon the agricultural community as their only source of patronage. Certainly, farm implement dealers have suffered immensely. Relatively little new farm machinery is being purchased but some dealers have been doing a strong business in the resale of equipment which has been obtained from farms going out of business, rehabilitated and resold. I suspect that those businesses have had to diversify and expand what they do. Some, for example, have taken on automobile sales agencies as a part of their business in order to compensate for the implement loss. I tend to think that most of the businesses will survive in New York State because the rural counties are gaining in population and the businesses will simply diversify into other types of activities and may increasingly have a smaller agricultural component.

3) IF THE AGRICULTURAL ECONOMY REMAINS PRETTY MUCH AS IS, WILL THE LOSS OF MAIN STREET BUSINESSES CONTINUE AT THE CURRENT PACE?

3. This question is largely answered as part of question two. There are some countervailing forces in rural New York which are probably not typical of the nationwide situation and, therefore, the small town commerical economy is not threatened to the same degree. We are, however, suffering from a need for more industrial types of employment to re-employ farm workers who no longer have certain opportunities available to them.

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4) WON'T THE DEPRESSED ECONOMY IN SMALL RURAL COMMUNITIES SOON BEGIN TO AFFECT LARGER COMMUNITIES AND EVENTUALLY THE ENTIRE RURAL ECONOMY?

IF YES:

HOW LONG WILL IT BE BEFORE THIS CHAIN REACTION TAKES PLACE?

4. It is not clear to me that the farm economy, per se, is distressed in New York State. We still have many large corporate and conglomerate farms which are doing very well. The problem is that the small family farm, which has traditionally been the backbone of our rural communities, are indeed facing increasing distress. Certainly, the economy is ultimately going to suffer nationally from the loss of the agricultural export market which has always been a strong part of our gross national product. Just how the causal relationships play out in this situation is somewhat problematical but the bottom line certainly is that a weakened agricultural economy will eventually cause distress in other parts of the economy as well.

5) IN CONVERSATIONS I HAVE HAD WITH SMALL BUSINESS OWNERS IN SOUTH DAKOTA, SEVERAL SAID THEY HAD EXPERIENCED LARGE LOSSES DUE TO FARMERS FILING BANKRUPTCY. IN YOUR VIEW, IS THIS A NATIONWIDE PROBLEM?

DOES THIS PROBLEM AFFECT A SIGNIFICANT NUMBER OF SMALL BUSINESSES?

IS THIS TREND INCREASING?

5. Banks in New York State generally have not sustained losses from agricultural bankruptcy. The major reason is that the real estate market in New York is strong due to the competition for land. While the fluidity of a farming operation may have disappeared because of the convergence of high costs and stagnant prices; there has usually been a sufficient asset remaining in the value of the land to protect any investments that the finanical community might have had. Consequently, there has not been wide spread pressure upon the assets of banks even though there certainly have been a number of bankruptcys on the farms themselves.

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8) IF YOU HAD ONLY ONE CHOICE, WHAT WOULD BE THE SINGLE BEST THING THE SBA OR ANY OTHER GOVERNMENTAL AGENCY COULD DO TO AID SMALL BUSINESSES AND COMMUNITIES THAT HAVE BEEN HARD HIT BY THE FARM PROBLEM?

8. The best strategy that I would suggest for economic development would be to provide venture capital for relatively small processing or manufacturing plants which utilize indigenous agricultural, forestry, or mineral products. Many of the success stories across the nation have been in the "widget business". One example is the small factory which builds cabinets into which large sophisticated electronic equipment is placed. The electronics manufacturer doesn's want to get into the furniture business, but the nature of what they produce means that the cabinets have to be virtually custom made. This has provided an outlet for some wood products and work for some local residents. Another example is a small firm that has gone into producing a kind of vodka out of an apple based alcohol.

Neither of these businesses employs very many people, but in the context of the small town, they do provide some important jobs and also a market for the products of other people. It is these double benefit investments that I think should be emphasized by any expansion of federal loans. I am not particularly supportive of loans which simply help retailers upgrade their retail operations since there is no evidence that such improvements actually increase the overall economic activity in a community even though they may certainly benefit the particular individual who happens to be the recipient of the loan.

Thank you for permitting me to express my feeling on these several points.

Sincerely,

CHARLES D. COOK

Senator

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Senator BAUCUS. Thank you very much.
Dr. Pulver, why do you not proceed next.

STATEMENT OF DR. GLEN C. PULVER, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF WISCONSIN-MADISON

Dr. PULVER. Thank you very much. I would like to submit my formal statement.

Senator BAUCUS. Yes, and if you could keep your remarks to about five minutes we would appreciate it.

Dr. PULVER. I am Dr. Glen Pulver from the University of Wisconsin, and I spend the major portion of my working time with communities and at the community level working with chambers of commerce, industrial development corporations, local businesses, and other community leaders who are interested in economic development, working with them and the cooperative extension service in the design of specific programs that will aid rural communities.

The two questions which are asked me most frequently are: One, what can we do to improve farm incomes in our area; and second, what are the primary off-farm opportunities that we have available to us in our area?

I would like to make just two or three points.

The first point I would like to make is that it is extremely important that we recognize the great diversity in rural areas. We commonly have a perception in our mind of what a rural area is—a collective set of farmers and a few other kinds of businesses. In many parts of our Country and many of our States other sectors dominate the economy and agriculture is only a small part.

The second point is that the major problem with regard to rural areas, in terms of income, is in the more remote regions—those areas outside of an hour's commute of a city of a size of 20,000 to 50,000 people. Thus the problem gets distributed in rather interesting ways around the United States and within our specific State of Wisconsin.

The next general point I would like to make, is that a solution to the rural problem will only come as a consequence of a comprehensive policy. It will not be solved by any specific policy.

To me the policies are essentially going to have to take three parts. Historically, we have tried to solve rural America's problems with a strong focus on farm policy. Farm policy now clearly is only one part of a three part policy framework. Clearly doing something to improve the incomes of farmers is vital to a large share of rural America.

The second aspect of policy would be in rural economic development policy. That is a sector which is in need of a great deal more attention at the current time. There has been previous testimony given with regard to the importance of the manufacturing sector and the goods producing sector, as well as the service sector.

It is important to look at the importance of the goods producing sector in national policy. It is important to maintain the competitive capability manufacturing as well as that of agriculture. What we do in terms of the manufacturing sector is extremely important.

But, we also must recognize that when you look at policy in terms of how it affects the local level and what opportunities local

communities have, very often their opportunities lie almost totally within the service sector. When we build national policy, we have to look at its effect in terms of the employment of the goods producing sector. But, when we provide supportive assistance at the local level it is important to be aware that for most small communities the opportunities are apt to be in the generation and expansion of their service sector.

The third policy needing attention is rural transition policy. It is clear that we have to help farmers, people employed in manufacturing, mines, forestry, and the whole rural sector into other kinds of occupations. That includes job counseling, training, and other elements. One of the things which I wish we might spend more time on in discussion is the issue of how we might build systems which are consistent across all of our economy and allow entry into those kinds of transition systems for people, regardless of where they happened to have generated their income in the past.

There are other policy considerations which are important. You have talked about deregulation and privatization. I would like to put emphasis on one which there is very little discussion—that is what happens when programs such as community development block grants and the cooperative extension service are reduced and/or are restructured. This might include the reduction of the Small Business Administration.

Policies focused on reducing these programs attack rural areas much more harshly than they do urban areas. Urban areas have a capacity to tax themselves much more widely to employ people who are skilled and knowledgeable with regard to economic development policy planning at the local level. In other words, an urban setting can find the resources to accumulate quite a sophisticated staff to deal with wise economic development policymaking. In rural areas, that obligation falls on volunteers, it falls on the local chamber of commerce and on the local government.

If we take away the very resource base rural areas need to provide them a bit of knowledge, we damage rural areas much more severely than urban areas. And thus, I would like to recommend the current initiative by the United States Department of Agriculture and the land grant colleges to try to get deeper involvement by the cooperative extension service in rural revitalization.

[The prepared statement of Dr. Pulver follows:]

ENHANCING JOB GROWTH IN RURAL AREAS

I am Dr. Glen C. Pulver, Professor of Agricultural Economics in the College of Agriculture and Life Sciences of the University of Wisconsin-Madison. My field of specialty is community economic development policy. My research is focused on two issues: service-producing industry contributions to economic growth and; capital market adequacy for business startups. I spend a large portion of my time in Cooperative Extension education at the community level, helping local governmental officials, Chambers of Commerce, industrial developers, bankers, business people and other interested citizens establish economic development programs to meet the specific needs of their communities.

The two questions asked me most frequently are: "What can we do to help improve the income of our farmers?" and "What are the off-farm employment opportunities with the greatest potential in our area?" People in rural areas throughout America are increasingly aware of the growing disparity between their incomes, living conditions and opportunities and those of urban Americans. Although often overwhelmed by international monetary practices, federal budget deliberations and other complex policy considerations, rural people seem committed to taking hold of those things which they can do to make a difference in the well-being of their own locality (Extension Committee on Organization and Policy, 1986).

It is quite clear that the single most significant force affecting the lives of rural Americans has been the recent drop in farm incomes and the precipitous fall in the value of farm land. Farm and directly related

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* Testimony presented to the Committee on Small Business of the United States Senate on March 5, 1987.

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agricultural enterprises account for 21.2% of total U.S. employment [Schluter and Edmondson, 1986]. Farming itself accounts for over 20% of the labor and proprietor income in 702 counties (29% of the nonmetropolitan counties) in the U.S. [Bender, et al, 1985]. This does not fully account for the income generated by agricultural input and processing firms, nor that of the businesses in small towns which are often nearly totally dependent on the spending of farm families [Beck and Herr, 1986].

Attributing the current rural income difficulty only to the farm crisis, misses other serious causes of the problem. In recent years, farmers and their rural neighbors have become increasingly dependent upon nonfarm sources of income. With sharp declines in farm numbers, more young people are seeking off-farm employment as their major income source. Some young people entering farming use off-farm employment as a means of capital accumulation. Many farm families have accepted off-farm work as a permanent part of their future. In 1982, nearly 38% of all U.S. farm operators worked off the farm over 200 days per year [Hines, Green and Petrulis, 1986].

In many rural areas, sharp employment declines in manufacturing, mining and forestry paralleled the drop in farm income in the early 1980s. Farm families with members working off the farm and their rural neighbors felt the blow. Manufacturing accounted for 30% or more of the labor and proprietor income in 678 counties (28% of all nonmetropolitan counties) in 1979. It accounted for 9% of total personal income in the 702 farm dependent counties mentioned above. In the same farm dependent counties, service-producing industries accounted for about 21% of total personal income, farming 20%, government employment 9%, dividends, interest, rent and transfer payment 32% and construction and mining the remainder [Bender, et al, 1985; Pulver and Rogers, 1986].

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The rural areas experiencing the most severe income declines are those in the more remote regions (areas outside of easy daily commuting distance of urban areas with growing employment opportunities). These remote regions have been most dependent upon farming, forestry and mining. They are less likely to provide alternative employment opportunities for families in transition or those seeking temporary or supplementary income sources.

In less remote regions, many rural families receive much of their income from nonfarm sources. Individuals may suffer severe losses in income from farming, but growth in other employment alternatives, particularly the service-producing industries, helps relieve the stress. Because these regions have a broad economic base to support their community infrastructure, they are not impacted as severely by sharp declines in agriculture or other natural resource based industries.

A Rural Policy Agenda

The fundamental question we must ask ourselves then is, "What can be done to offer rural Americans hope of improvement in their relative economic well-being?" It seems evident that a comprehensive effort is necessary if people living in rural areas are to experience satisfactory economic well-being. A policy agenda aimed at helping people in rural America should be composed of three parts: farm policy, rural economic development policy, and rural transition policy.

Farm Policy: The cornerstone of any policy aimed at improving the well-being of most rural areas, is the maintenance of a healthy agriculture. Although farm policy is not the major purpose of this hearing, I would like to make two points which I feel are of importance to the topic of our discussion.

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First, the U.S. is more than self-sufficient in food production and must compete in world markets. Continued commitment to the generation of new agricultural technology is necessary if we are to retain those comparative advantages in agriculture which we now enjoy. Nonetheless, this will reduce the quantity of land and labor necessary to produce food. Research in biotechnology may enhance the overall economic well-being of the public at large, but it will have a tremendous negative impact on some farm families, unless alternative uses are found for "freed up" resources. Serious study is needed on potential nonfood uses for the biomass producing capability of rural America. This critical concern deserves much more than the minimal attention it currently receives by both the private and public sector.

Second, for years farm price policies have been the central mechanism used to provide income assistance to farmers. The government has purchased commodities, compensated farmers for diverted land, provided rewards for "whole herd buyouts," established high import tariffs, etc., all with the intent of raising farm incomes. The major benefits of these programs have gone to the larger producers. The distributive effect is not uniform across rural regions. The most severely depressed rural region may be helped the least. A much wider range of strategies is available, including restrictions on business entry, direct compensation for income lost, need based programs and supplemental income. Continued insistence on costly price oriented policies in the face of declining farm voter numbers is apt to prove disastrous to rural America. The specific objectives of a new rural agenda might be better met by strategies which are more universal (e.g., need based programs) than those focused on a rather narrow price oriented policy.

Rural Economic Development Policy: As farm, forestry and mining opportunities decline, alternative employment and income sources must be

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enlarged if rural areas are to remain economically viable places. Small businesses play a key role in the provision of jobs and economic well-being in rural America. In nonmetropolitan areas of the U.S., firms with less than 100 employees generate about the same number of net new jobs as larger firms. Businesses with less than twenty employees and those in the trade and service sector have led the way in recent years. Firms rarely migrate from one area to another in the U.S., and thus constitute a small fraction of job growth potential for most communities. New business establishments (a combination of new branches of affiliated firms and local startups) create about the same number of jobs in the U.S. as expansions of already existing establishments [Miller, May, 1985; Miller, October 1985]. There is little evidence of an urban or rural bias in the historic employment growth patterns of those industries (primarily service-producing) which are expected to generate the largest number of new jobs in the next ten years [Pulver, 1986-I].

The primary burden for income and employment growth in this country lies with the private sector and increasingly with small business. The public sector can do much to stimulate the growth of private sector employment in rural areas. The five general strategies which might be used are to: (1) increase the efficiency of existing firms; (2) encourage business formation; (3) attract new basic employers; (4) improve the ability to capture dollars; and (5) increase aids from broader governments [Pulver, 1986-II]. A number of policy initiatives might be used to implement each strategy.

--Increase the Efficiency of Existing Firms: The ability to be competitive over time is the greatest assurance a firm can have of its capacity to maintain or expand an operation in a specific locality. Existing firms can be strengthened by business management, science and engineering education and counseling. Barriers to growth may be uncovered by a program

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of regular visits by community leaders to the managers of businesses which already exist in the area. Expansion may be encouraged through the development of capital sources.

--Encourage Business Formation: There is a continuing need for new enterprises to meet changing demands resulting from population growth or evolving goods and services. Individual counseling and intensive education could be provided to those interested in business formation. Studies of market potential may identify opportunities for new establishments. Seed capital may be used to stimulate startups.

--Attract New Basic Employers: The attraction of new branch locations of firms headquartered elsewhere represents a real opportunity in rural areas. Through the multiplier effect, other jobs and income are added. New industries might be encouraged to locate branches in specific communities by the development of industrial, office or commercial sites. The development of community facilities (e.g., transportation, communication, business services) necessary to attract new employers also benefits existing businesses.

--Improve the Ability to Capture Dollars: Every dollar expended in a community for retail and wholesale goods and services as well as industrial inputs adds to local employment and income. The share of the market captured in rural areas can be improved through action on consumer, industrial and local government buyer surveys. Contemporary purchasing and marketing techniques can be taught to business operators.

--Increase Aids from Broader Governments: Dollars taxed away from any community to broader governmental units have a negative effect locally unless returned through some form of expenditure. For example, one major government expenditure is in the form of social security payments to the elderly. Well

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organized transportation, meal services, outpatient health care and other services focused on the elderly can make rural communities more attractive places in which retirees might chose to live. Their personal expenditures in the community can generate many jobs.

There is a critical need in rural areas for careful community economic analysis, planning and action. Local leaders must know which strategies and policies have the greatest potential for job and income generation within their resource conditions. Small communities must be especially efficient in the use of limited volunteer time, local funds and state and national programs if they are to meet their economic development goals.

Rural Transition Policy: The need to ease the transition of families, adults and youths, from their current circumstance (farming, forestry, mining, manufacturing and related businesses) to more productive employment will continue. Policy objectives might include temporary income support programs for those who must change occupations, improved job counseling and training and fundamental psychological and human support structures which recognize the unique conditions of specific industries such as farming and small town businesses.

Other Policy Considerations: While developing policy focused on rural areas it is important to insure that other public decisions (e.g., deregulation, privatization, monetary policy, government expenditures, international trade regulations) do not place rural areas at a comparative disadvantage. For example, the deregulation of the airlines aimed at gaining the efficiencies of a more free market may raise transportation costs in rural areas reducing the competitive ability of their business. Likewise, urban areas have greater local taxing capacity than rural areas. Reductions in domestic government spending for programs such as Community Development

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Block Grants and Cooperative Extension reduces the critical assistance needed to help rural community leaders to make wise economic development policy choices. The current initiative of the U.S. Department of Agriculture and Land Grant Universities throughout the United States to place greater emphasis on Rural Revitalization is an example of a constructive effort deserving support.

Summary

The current economic crisis in rural America is a consequence of a complex set of forces both on and off the farm. Rural family incomes are increasingly dependent upon off farm incomes. Rural America is no longer responsive to farm policy alone. A new agenda for rural America will need to be more comprehensive including farm policy, rural economic development policy and rural transition policy.

Opportunities exist for economic growth in rural areas. Well designed public policy can stimulate a healthier agriculture and the expansion of other businesses, the attraction of new branches of firms and the creation of new businesses, all in rural America. No amount of public action will guarantee a healthy, vibrant rural economy. Inaction or misdirected policies assure continued trauma for millions of rural families. Comprehensive rural development policies offer the best hope for the future well-being of rural America.

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(I recommend the following three publications be placed in the record: "Elements of a Comprehensive Rural Development Policy" by Glen C. Pulver of the University of Wisconsin-Madison; "Community Economic Analysis -- A How To Manual" by Ron Hustedde, Ron Shaffer and Glen C. Pulver, published by the North Central Regional Center for Rural Development, Iowa State University; and "Community Economic Development Strategies" by Glen C. Pulver, published by the University of Wisconsin-Extension. All offer specific technical information of direct relevance to the subject.)

(Material retained in committee files.)

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Senator BAUCUS. Thank you very much, Dr. Pulver.
Dr. Drabenstott.

STATEMENT OF DR. MARK R. DRABENSTOTT, RESEARCH OFFICER AND ECONOMIST, FEDERAL RESERVE BANK OF KANSAS CITY, KANSAS CITY, MO

Dr. DRABENSTOTT. Thank you, Mr. Chairman.

The winds of change are blowing across the rural economy, and the changes extend well beyond agriculture. The troubled farm economy has received much public attention in the 1980's, but too much emphasis on agriculture will lead us to overlook a much broader rural economic adjustment.

That adjustment involves roughly a fourth of the U.S. population and four of every five counties in the country. Put simply, the rural economy is undergoing fundamental economic change that is unlikely to be stopped. The challenge for everyone, including policymakers, is to accommodate the change in a forward looking, not a reactive, way.

In light of the structural changes now under way in rural America, I commend this Committee for examining the problems in the rural economy. I will summarize my formal statement by reviewing the recent performance of the rural economy and examining policy responses to emerging rural economic problems. My statement draws on research done at the Federal Reserve Bank of Kansas City. Mark Henry of Clemson University and Lynn Gibson, a research associate at the bank, made valuable contributions to that research.

What is rural America? I think this is a key question as we consider the rural economy. As has been noted already this morning, contrary to the popular notion that rural counties depend primarily on agriculture, manufacturing is the dominant rural economic base.

Of the 3,000-odd counties in the U.S., roughly 2,400 are non-metropolitan. Of these, only a fourth—and representing only an eighth of total rural population—depend mostly on farming.

Manufacturing dependent counties, on the other hand, account for more than a third of the rural population. Thus, I would stress, as have others this morning, that we must broaden our thinking beyond agriculture when we focus on rural economic problems.

How well is the rural economy doing? Not very well. The incomes of rural residents have been steadily falling behind those of urban dwellers. The gap has widened most sharply in the 1980's, but the problem actually dates to the mid-1970's.

Rural America has become a composite of a few winners and many losers. As Mr. Deavers stressed, traditional rural counties—those dependent on agriculture, manufacturing and mining, have fallen further behind urban incomes. Rural counties that depend on retirement and Government activities, accounting for only a quarter of the rural population, have been the only rural counties that have continued to make economic progress in the 1980's.

The varying performance of rural economic bases points out some regional patterns in the rural economy. Agricultural regions, mostly the upper Midwest and Plains, have been hard hit by farm

problems. Rural manufacturing regions, primarily the South, have been hurt by industrial decline. Mining areas, the southern Plains and Mountain States, have been sharply affected by the energy recession.

A major cause for rural economic decline in the 1980's is international economic forces. Mounting international competition, weak world demand for the products made in rural America, and the strong dollar of the early 1980's all put traditional rural industries on the defensive.

The urban economy has been able to offset these global forces due to its diversity and by turning to the surging service sector. The rural economy, on the other hand, has essentially been left behind in this shift to services.

The strained rural economy poses two principal economic issues for policymakers. First, the number of displaced rural workers is mounting. Rural unemployment rates, as has already been noted, have risen sharply compared with the 1970's and are now well above urban rates. These displaced rural workers generally do not have job skills that fit well with available jobs. Second, rural communities face a more difficult task maintaining rural infrastructure while at the same time trying to attract additional businesses.

How can public policy respond to rural economic problems? Policymakers appear to face a basic choice. They can implement a rural transition policy, one which aims to facilitate and ease the costs as rural resources adjust to new economic realities. Alternatively, they can implement a rural development policy, one which seeks, to some degree, to reverse current market forces. Or they can combine the two policies, easing adjustment in rural areas with little growth potential and stimulating development in areas with more potential. Such a combination may be the best rural policy.

A rural transition policy might have three objectives: easing human resource adjustments, as Dr. Pulver has suggested; easing infrastructure adjustments; and supplementing rural incomes.

Retraining programs do appear to be an important policy initiative in meeting these objectives. Infrastructure programs to allow public services to continue in communities that need them, while still allowing structural change to continue, will offer a particular challenge to policymakers.

The chief objective of rural development policy is to ease the transition from narrow, weakening economic bases to new, more diversified economies. To meet this objective, the federal role may best involve careful investments in rural infrastructure, while allowing state programs and local business decisions to influence local business activity. Federal infrastructure programs then become the catalyst to rural development.

Whatever rural policy is chosen, one of the first requirements for policymakers is to define rural policy. Clear rural policy objectives are needed. Farm policy traditionally has been regarded as a close surrogate for rural policy, if not an exact substitute.

The question must be asked whether current farm programs meet broader rural objectives. The farm policy efforts of the 1930's might have legitimately been rural programs. Then, a quarter of

the U.S. population lived on farms and more than half the rural population lived on farms.

That is not true today. It appears quite possible to me that farm policy may be too narrowly focused to meet broader rural goals. If so, some of the public funds now going to farm programs may need to be redirected to rural programs as a rural policy is implemented.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Drabenstott follows:]

AN OVERVIEW OF THE RURAL ECONOMY AND RURAL POLICY

Testimony Presented To

Senate Small Business Committee's Subcommittee
on the Rural Economy and Family Farming

by

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March 5, 1987

The views and opinions expressed herein are solely those of the author and do not necessarily represent those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

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The winds of change are blowing across the rural economy. Farms are going out of business, main street merchants are boarding up store fronts, and banks are failing. The dramatic changes stand out in sharp relief against the prosperous 1970s, a decade that brought renewed optimism to rural America.

The changes sweeping rural America extend well beyond agriculture. The troubled farm economy rightly has received much public attention in the 1980s. But too much emphasis on agriculture will lead us to overlook a much broader rural economic adjustment. That adjustment involves roughly one-fourth of the U.S. population and four of every five counties in the United States. Rural America--the nonmetropolitan segment of the U.S. economy--with few exceptions has not fully participated in the U.S. economic expansion that is now more than four years old.

Put simply, the rural economy is undergoing fundamental economic change that is unlikely to be stopped. The challenge for everyone, including policymakers, is to accommodate the change in a forward-looking, not a reactive manner. Rural America is unlikely to return quickly to the halcyon days of the 1970s on the wings of booming exports and vigorous business activity. Thus, it is all the more important to understand how the rural economy is changing, and to take effective steps to make the most of those changes.

For all the above reasons, I commend this committee for examining the problems in the rural economy. My statement addresses three areas. First, I review the recent performance of the rural economy relative to the urban economy. Second, I present the rural economic problems that will most likely concern policymakers. Finally, I examine two policy responses to these problems--rural transition policy and rural development policy. Research conducted at the Federal Reserve Bank of Kansas City over the past year forms

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an important base for my remarks, and I am attaching two articles from the Bank's Economic Review to my statement. Mark Henry, a professor at Clemson University, and Lynn Gibson, a research associate at the Bank, made valuable contributions to that research and this statement.

RURAL ECONOMIC PERFORMANCE

The rural economy seems likely to receive increased attention in the period ahead. The proper starting point for this gathering interest is the question: "What is rural America?" Most observers equate rural and farming. But that is not really the case. Contrary to the popular notion that rural counties depend primarily on agriculture, manufacturing is the dominant economic base of rural America. Of the 3,000 odd counties in the United States, about 2,400 are nonmetropolitan. Only a fourth of these rural counties depend mostly on farming for their incomes, and those counties account for only an eighth of total rural population and income. On the other hand, nonmetropolitan counties which depend on manufacturing account for more than a third of total rural population and income. Or viewed another way, rural counties dependent on government, retirement, and trade account for about the same proportion of rural population and income as farm-dependent counties. Thus, we must broaden our thinking beyond agriculture when we focus on rural economic problems.

How well is the rural economy doing? Not very well. We reached that conclusion in a recent study. The well-being of rural residents, as measured by real per capita income, has been steadily falling behind that of urban dwellers. The gap has widened most sharply in the 1980s, but the problem really began to develop in the mid-1970s.

Rural America has become a composite of a few winners and many losers. Based on our analysis, incomes in traditional rural America--nonmetropolitan

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counties dependent on farming, mining, and manufacturing--have fallen further behind urban incomes, after making little or no progress in the late 1970s. As we have defined it, traditional rural America includes half the total rural population. Rural counties that depend on retirement and government activities, which account for about a quarter of the total rural population, have been the only rural counties that have continued to close the rural-urban income gap. As you know, these are counties whose fortunes are influenced by federal spending, either through transfer payments or direct federal activities.

The varying performance of rural economic bases suggests some regional patterns in the rural economy. Agricultural regions--mostly the upper Midwest and Plains--have been hard hit by farm problems. Rural manufacturing regions--primarily the South--have been hurt by industrial decline. Mining areas--the southern plains and Rocky Mountain States--have been sharply affected by the energy recession.

Is the rural economic decline of the 1980s a cyclical or structural problem? We concluded the problem is overwhelmingly structural in character. An analysis of the gap in rural and metropolitan incomes compared with overall activity in the U.S. economy reveals no cyclical link. In short, the rural problem has its roots in fundamental factors, such as international markets, infrastructure, and education, not in the business cycle.

Exploring the causes of rural economic decline in the 1980s does reveal a common rural theme. That theme is that rural America has been buffeted by international economic forces in the 1980s. Quite clearly, mounting international competition has put many rural businesses on the defensive in the 1980s--from the Kansas wheat farm, to the Washington lumber mill, to the South Carolina textile factory. The strong dollar in the first half of the

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1980s intensified the competition by giving foreign producers some price advantage. A deep world recession cut demand for many rural products traded in world markets, including food and energy, so that producers in the United States and elsewhere were left to compete for stagnant markets. Many international markets, especially for commodities, remain weak as the economic and financial effects of the sluggish world economy linger.

The net result of these international factors is that U.S. industries that export or compete with imports have not done well in the 1980s. Moreover, such industries may be unable to regain previous market shares. And it is just such industries that form the economic backbone of the traditional rural economy. In short, many rural industries are undergoing long-term structural declines. This conclusion is well illustrated in Kansas, a state in our Federal Reserve District. The state's three main industries are agriculture, energy, and general aviation. You all know how agricultural exports continue to languish. The problems of the Kansas oilfield are directly tied to world energy market developments. And the general aviation industry, an industry centered in Wichita with effects on the rural economy, remains depressed due to slumping sales domestically and abroad.

The international forces just discussed have also hit the urban economy. But metropolitan areas generally have more diverse economies that buffer some of the effects. Kansas City, for instance, is enjoying brisk business conditions. Meanwhile, a survey of rural banks across our seven-state district indicates that one of four rural nonfarm businesses is in serious financial difficulty.

The urban economy has also been able to offset international economic forces by turning to a surging service sector. The rural economy has not benefited nearly as much from this shift to services. In 1984, for example, seven of eight service jobs were located in metropolitan areas.

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In short, rural economic problems extend throughout the rural economy. Agriculture's problems are well known. Rural manufacturing has been stagnant or declining for a decade. Dramatic swings in global energy markets have brought difficult times to the U.S. energy industry, much of which is located in rural areas. Rural economic strength in the 1980s has been confined to a relatively small portion of rural America--those counties which depend on government or retirement activities.

EMERGING RURAL ECONOMIC PROBLEMS

With the rural economy under stress, two principal economic issues face policymakers. The first is the mounting number of displaced rural workers. The second is the accelerated pace of structural change in rural communities leaving in its wake additional strains on rural infrastructure.

Many rural people are now and will continue to be in transition. After remaining low in the 1970s, the rural unemployment rate has risen in the 1980s, to levels well above urban levels. Underemployment is a persistent rural problem that only compounds the rural labor situation. Rural outmigration certainly is not new, but rural emigrants today face much less attractive employment alternatives than they did in the 1950s and 1960s, a period when the rural population declined quite rapidly. Policymakers, therefore, face the problem of easing the transition of rural displaced workers whose job skills may not fit well with job opportunities elsewhere in the economy.

Strains on rural infrastructure may be the least discussed rural problem in the 1980s, but the stress is mounting. Rural communities increasingly face a dual problem--fewer resources to maintain public services and insufficient resources to support the transition to new economic bases. Many neighboring rural towns and counties are struggling to maintain what have become redundant

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public facilities. In some regions, for example, one court house could more efficiently provide the public services now meted out by two. On the other hand, new infrastructure needs for economic diversification place especially difficult demands on rural tax bases, demands which many rural communities have not yet met.

RURAL ECONOMIC POLICY

How can public policy respond to rural economic problems? Policymakers appear to face a basic choice. They can implement a rural transition policy, one which aims to facilitate and ease the costs of rural resource adjustments. Alternatively, they can implement a rural development policy, one which seeks to reverse current market forces and stimulate economic activity in rural areas. Or they can combine the two policies. Such a combination, one which eases economic adjustment in rural areas with little growth potential and stimulates development in rural areas with greater potential, may be the best rural policy.

In any case, one of the first requirements for a policy response is to define rural policy. Traditionally, farm policy has been regarded as a close surrogate for rural policy, if not an exact substitute. Farm policy has distinct form and undergoes systematic revision. Rural policy has no clear dimensions. Before federal and state rural programs are considered, a federal rural policy should be chosen to guide those programs most effectively. In short, rural policy objectives are needed.

Rural transition policy

The aim of rural transition policy is to ease the social costs as considerable amounts of rural resources adjust to new economic realities. There is sound economic justification for such a policy. Put simply, rural resources--whether human or capital--adjust only slowly to economic forces,

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and costs attend that adjustment. It is in the public interest to reduce the social costs by facilitating the resource adjustments.

A rural transition policy has three objectives. Easing human resource adjustments is the primary objective. Retraining programs are best suited to meeting this objective. The federal government has long had retraining programs, but the programs have not been aimed at rural problems. States are beginning to implement retraining programs, but additional emphasis will be needed to meet the problem. The federal role in rural retraining efforts, whether federal programs or expanded partnership in state programs, will need to be examined.

Easing rural infrastructure adjustment is another transition objective. The federal government and states may be able to assist rural communities that lack fiscal resources to maintain essential public services. Grants-in-aid might be linked to community agreements to share responsibility for public services. In this and other programs, the challenge will be to craft means of public support which allow services to continue in communities that need them while still allowing structural changes in the rural economy to continue.

Supplementing rural incomes during the rural economic transition is a short-run policy objective. Government support is no substitute for long-run economic growth, but policymakers may want to support rural incomes for a period of time. That is an inherent objective of farm programs. Rural policymakers will want to examine how well farm programs achieve broader rural income goals. Also, the role of other income transfer programs may need to be reexamined in light of structural change in the rural economy. Social security, for example, will become more important to rural communities with aging populations. Overall, direct income transfer programs probably meet fairly limited objectives but still may serve to soften the effects of rural change.

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The rural development policy

A rural development policy is a much different policy response to rural economic decline. Rural development policy seeks, to some extent, to reverse market trends. Rural development policy, then, rests on social grounds and much less on economic grounds. The United States does have a long history of rural development programs on which to base its rural policy. In addition, policymakers may view maintaining some segments of rural infrastructure--education, transportation, industrial plant and equipment--as integral to long-run economic competitiveness in industries such as agriculture. Prolonged economic stress will result in the deterioration or closing down of major components of the rural infrastructure. Policymakers may choose to offset some of that deterioration for a period of time.

Easing the transition from narrow, weakening economic bases to new, more vigorous and diversified economies is the most appropriate objective of rural development policy. To meet this objective, the federal role may best involve careful investments in rural infrastructure while allowing state programs and local business decisions to influence local business activity. Care will need to be taken in federal infrastructure investments because funds are likely to be scarce and investments will be most effective when located in rural regions that already possess attributes that are attractive to private investment. Thus, federal rural infrastructure programs can be viewed as catalysts for rural development.

Rural development policy, in one of its forms, can be regarded as a two-pronged response to rural economic problems. Policymakers may want to facilitate economic adjustment in rural areas with little prospect for economic revival, while at the same time stimulating business activity in areas with greater growth potential. The problem with this dual approach is

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that it necessitates a sort of policy triage--deciding which rural areas have characteristics conducive to growth and then targeting programs accordingly.

Business development programs--subsidies to attract industry to rural areas--are the province of state and local governments. If the federal government has a clear rural policy and is involved in rural infrastructure investment, state and local programs to stimulate business activity can be directed accordingly. But without clear federal policy direction, state and local efforts may be much less effective.

Overall, rural development policy involves a long-run commitment to stimulating economic growth in rural areas. The federal role appears to be investing in rural infrastructure for both the development and transition of the rural economy. Education may be one of the most important parts of the rural infrastructure. Agriculture, for example, increasingly finds that its comparative advantage stems much less from actual farm production and much more from the technology inherent in the transportation, handling, and processing system. Ongoing basic research and the application of new technology in this system will be key to U.S. agriculture's future success. States and local communities will be left with the greatest rural development task--attracting businesses to rural locations.

Farm policy and rural policy

As public interest in rural policy grows--whether that interest is in rural transition policy or rural development policy--the clear differences between farm policy and rural policy need to be understood. The farm policy efforts of the 1930s might have legitimately been rural programs; that is not true today. In the 1930s, a quarter of the U.S. population lived on farms, and more than half of the rural population lived on farms. Today, only 3 percent of the U.S. population live on farms, and only a tenth of the rural

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population are farmers. Moreover, nonfarm income is more important than farm income for 2 of every 3 farms in the United States.

The question must be asked, therefore, whether current farm programs meet broader rural objectives. Farm programs do keep farm income high and improve business activity in areas dependent on farming. And in the absence of clearly stated rural policy, farm programs are the primary source of public support to rural America. But as I noted earlier, only a fourth of the nation's rural counties--and less than 12 percent of the rural population--depend primarily on agriculture. Despite these facts, farm programs continue to receive considerable support. I have been impressed by public opinion polls that continue to indicate broad support for farm programs, even as the costs of those programs have mounted in recent years. Let me suggest that many citizens may support farm programs because they believe--incorrectly, I might add--that the programs will achieve the rural goals they value. In short, policymakers must decide if farm programs, currently the primary policy link to the rural economy, may be too narrowly focused to meet rural objectives. If so, some of the public funds now going to farm programs may need to be redirected to rural programs as rural policy is implemented.

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ATTACHMENTS

Mark Henry, Mark Drabenstott, and Lynn Gibson, "A Changing Rural America," Federal Reserve Bank of Kansas City, Economic Review, July/August 1986, pp. 23-41.

Mark Drabenstott, Mark Henry, and Lynn Gibson, "The Rural Economic Policy Choice," Federal Reserve Bank of Kansas City, Economic Review, January 1987, pp. 41-58.

(Material retained in committee files.)

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Senator BAUCUS. Thank you very much, Dr. Drabenstott.

Gentlemen, I would like to ask each of you, what in your judgment is the Federal policy or program that works best, and worst, in trying to help small business in rural communities.

I will give you a little leeway there—what Federal programs tend to work the best, and which tend to work the worst?

Who wants to take a shot at that?

Dr. PULVER. I will start, knowing all the risks associated with starting here. My observation would be that if you want to look at the issue of rural economic development policy, setting aside farm policy per se, one of the difficulties is that we do not have a policy which focuses on the area, so one has to look at the consequences of a whole lot of other efforts in terms of the effects that they may have.

A pair of programs which I think have been really useful in our State, particularly in rural areas——

Senator BAUCUS. I am sorry, your State is?

Dr. PULVER. Wisconsin.

Programs which have been very helpful in our state, have been the guaranteed loan programs of both the SBA and Farmers Home Administration in terms of direction of some assistance at least to small businesses in rural communities. Our state, by examination you will see is taking very strong advantage of those programs; and it is an important adjunct to our effort.

A Federal program insofar as it is a combination of State, Federal, and local funding, is the cooperative extension service. We have the largest commitment of any State in the United States to local assistance to rural economic development and other natural resource policy at the local level. And the support which we have gotten, although very little of it direct in that regard, has been very useful.

I am of course reluctant to attack and identify what would be a worst program.

In my sense, in a worst sense, I guess I would have to say that I have probably identified that already. The effort to try to withdraw some of the direct support to economic planning, has been very hurtful.

But I would also say that we can identify some specific efforts in deregulation, particularly in transportation and some other efforts, which bode very poorly. For example, if you are trying to establish the headquarters of an important service industry in central Wisconsin and you discover the cost to get from Wassau, Wisconsin, to Chicago by air now is extremely high, you will suddenly be discouraged about the prospects of expansion in that environment.

Senator BAUCUS. Thank you for going first.

Who wants to go next?

Dr. DRABENSTOTT. I would agree with Dr. Pulver. I would not describe the worst Federal program, but I would describe a lack of clear rural policy direction. I think that to some extent we see many states——

Senator BAUCUS. Direction where?

Dr. DRABENSTOTT. Lack of direction in a clearly stated rural policy, what the Federal rural policy objectives are, what the Federal role is going to be in meeting those objectives, and what the

corresponding roles for States and local communities are going to be.

If, for example, Mr. Chairman, you were to look at what is happening in states across the heartland, there is a great deal of interest in rural development. One of the problems is that the states are sometimes working at cross-purposes. In part, I think that is due to a clear direction from the Federal Government as to what their role in rural development is going to be.

And I think defining that——

Senator BAUCUS. For example? What causes that cross-purpose effort? You say that is in part because of directions from the Federal Government?

Dr. DRABENSTOTT. From a strategic perspective, I think there is a general lack of cooperation among States to meet rural development objectives. And I would lay some of the blame for that lack of cooperation to the fact that there is no clearly defined Federal role in rural development programs.

Senator BAUCUS. Are you implying that, even though a little competition is a good thing, that perhaps in this area it is too self-destructive?

Dr. DRABENSTOTT. Yes, I would agree with that, Mr. Chairman. For example, if you look at neighboring States in our part of the country—Kansas, Nebraska, Oklahoma, the Dakotas—many of these States are going to face difficult problems providing retraining programs for people that leave rural areas.

In many respects, they would benefit from some sharing of those retraining efforts. The Federal Government might be able to play a role in bringing about some of that cooperation.

Senator BAUCUS. Are there any present Federal programs that you can point to that have worked?

Dr. DRABENSTOTT. I would say that the Federal infrastructure programs historically have been quite successful in stimulating rural development. There have been many studies done, for example, in the Appalachian region that suggest that investments in rural infrastructure were quite successful in stimulating rural development in those areas.

As I have suggested, I think carefully targeting investments in rural infrastructure will be a very beneficial federal role.

Senator COOK. If I could give you an example of the transportation problem, next week I have to travel to Montgomery, AL. The round trip air fare from Albany, NY, to Montgomery, AL, is I think $626.

I also in the airport saw a sign where I could fly from New York to Switzerland for a ski weekend and return for $399. I might take that alternative. [Laughter.]

Nevertheless, in terms of good programs, the one that probably has been most useful in our area has been the Appalachia region program. It has had great diversity. It has been used to great advantage, and I think it has been a great boon to us.

The greatest problem area that I would identify—and it does relate to agriculture—has been, and perhaps this has been corrected and I am not an expert, I do not know, has been the tax treatment of the way in which commercial enterprises could write off investments in agriculture.

And in my home county, which is not huge, but one corporation purchased 40 family farms in succession, held on them for a relatively brief period of time, and took all the tax benefits that they were able to take from it, have now moved on. And the last thing I understood, that they were getting subsidized in Canada for going up there and doing something in Canada.

I will not say that these people have been totally destructive, but what this does to the infrastructure, economic infrastructure of a community, is change this from the family farm concept to where everybody is a farm employee, and then the employer leaves and you don't have the employment at all.

And I think that the tax laws really, if they have not already been changed in that regard, should be examined carefully.

Senator BAUCUS. I think that is an excellent point. We have not looked at the tax code to see how it creates incentives or disincentives to grow or to compete. The Tax Reform Act tried to address equality and tried to address equity, simplicity and equity.

We did not pay any attention, unfortunately, to growth and particularly how it affects international competitiveness. It is a major problem.

One final question. What about other countries' models or programs? Are any of you aware of any similar efforts or undertaking in other countries that work? Have you had a chance to look at that?

Dr. PULVER. The models that have been successful in maintaining a strong rural economy are completely different governmental models, strongly different at least. For example, in Norway where they have a commitment to maintenance of——

Senator BAUCUS. I will be practical, pragmatic about this. What has gone on in other countries that works in addressing this problem?

Dr. PULVER. They have essentially directed specific financial assistance to housing and the maintenance of income support to people who have establishments, whether they are farming or nonfarming establishments, in the rural environments, as a direct income support mechanism.

And I think that would be somewhat difficult in this environment. I do not see anything that is easily transferable, that is the problem.

Senator COOK. I think the difference between the European model, for example, and the United States is that the whole, if I can use that word, socioeconomic structure is much more stable there. There is not the shifts that take place between States that grow rapidly and States that lose population rapidly and people who move around.

The population distribution within those nations stays relatively stable, and therefore programs that are put into place tend to work over the long run. And I think one of the problems we have in this country is, because we are so mobile, that we tend to move out of the way. Once we get a program in place, the people are not there any more in the place for the program.

Senator BAUCUS. Well, it is an excellent point. You touched on education in your opening statement. You know, people talk about Japan. The fact is that I think we get hung up on, although it is

important, the number of days that Japanese kids go to school, 240 days a year, versus our 180. Also, by the time Japanese kids graduate from high school they have virtually 3 or 4 more years of education than do American kids.

But that is not the main point. The main point is that, as I understand it, that equality of educational opportunity is much more a reality in Japan than it is in our country. That is, there is no tracking system in Japan. Kids go to school, they get the same opportunity with high quality teachers throughout the country.

Then they take the exam to see if they get into senior high from junior high. And again, in senior high, no tracking. You have got the same teachers, although your mother may tutor you in addition so you pass the last exam that determines whether you get into college.

But the point is there a truer equality of educational opportunity, which helps provide better mobility.

So if our country had the high educational standards plus equality of opportunity, then the kids could, when they grow older, transfer to different parts of the country and meet some of the kinds of problems that you were addressing.

Dr. DRABENSTOTT. Mr. Chairman, if I could make a comment in response to your statement. I think that educational resources for rural areas are going to be very important in the period ahead, for two critical reasons.

One, I think there is going to be a demand for retraining services, and there is a problem in the rural communities that as the tax base declines it becomes more and more difficult to maintain that high level of education.

Senator BAUCUS. No doubt about that. You know, that if someone graduates from high school today he or she is going to have six to seven different jobs by the time he or she retires.

There is more mobility with increases in technology. That means more emphasis on retraining and on skills to adapt quickly to new kinds of jobs than would have been the case years ago.

Dr. DRABENSTOTT. And I would suggest that one segment of a rural policy, Federal rural policy, might be to examine what role the Federal Government might play in sharing some of the transitional resource costs to predominantly rural States.

The second point I would offer is that there is a great deal of interest across the heartland in what role universities are going to play in spurring economic development. That is another area where, if there were a clearly defined Federal role, could serve to coordinate some of those efforts to spur economic development and strengthen the linkages between universities and the private sector. I think that would be advantageous as well.

Senator COOK. Could I expand, and perhaps I am opening up a new area, but recently our commission has been looking at health care and I have come across some very interesting dilemmas in the past three weeks, one being hospitals cannot get nurses. You cannot hire nurses.

Second, nursing schools cannot get students. We have nursing schools all over the place. Students are not attracted to go into nursing.

We have DRG systems in place which require people to go home and assume the existence of home health care services, and yet we find that over the past 3 or 4 years the average home health agency has been losing employees at the rate of perhaps 10 percent a year.

The dilemma of this is when we have, as everybody has indicated, a pool of workers out there who do not have jobs, we have jobs that are going begging in some very, very crucial areas in rural communities. The education component is a part of it, but also is priorities in terms of what our economic system—how our economic system looks at the value of certain types of employment.

And with the changing demographics, the aging population, the importance of health care workers and social workers and people of that nature who have kind of been at the bottom of the economic ladder has to be re-examined, not in terms of whether it is good or bad, but simply in terms of whether we are going to be able to find these people in the first place; and second, in terms of providing an employment opportunity which is something that we certainly need.

Senator BAUCUS. I appreciate that.

One final question. Do any of you know what digital switching is? [Laughter.]

Just thought I would ask. Thank you very much.

OK, final panel: Mr. Don Peoples, chief executive officer of Butte Silver Bow, MT; Mr. Don Stringham, chief executive officer, Genexus, Inc.; and Mr. David Martin, executive director of the Arrowhead Regional Development Commission, Duluth, MN.

Gentlemen, I appreciate your presence here. I would like you to go ahead, first Don. Let me introduce Mr. Peoples. When I say this, I mean it: I do not know anybody in public service who is a more dedicated public servant, bar none, than Don Peoples.

Don Peoples, for those of you in the room who do not know, is from Butte, MT. Butte, MT, has gone through a lot of the kinds of problems we have been talking about today. Butte, MT, has seen Arco pull out. But the Butte people have more heart and soul, spirit, and optimism, creative energy, in my judgment than most any other group of people than I have ever known.

And Don Peoples exemplifies that. He has led Butte, which is down in the doldrums, to become the shining star in our State.

It is a real honor, Don, to have you here today. If what you have is contagious, then this country is going to be number one economically.

STATEMENT OF DONALD R. PEOPLES, CHIEF EXECUTIVE OFFICER, BUTTE-SILVER BOW, MT

Mr. PEOPLES. Thank you, Mr. Chairman. With that fine introduction, I suppose I should just close and leave the room. But it is a pleasure to be here.

Senator, interested people: Butte is a very interesting town. It has a very interesting history. It may be one of the few communities in the United States that has undergone the transition from a metropolitan area to a rural area. Copper mining was responsible

for the growth of Butte into a cosmopolitan city which in 1920 had a population of over 80,000 people.

We have gone through a lot of difficult times in Butte. We have had recessions, depressions. We have gone through the changes in the methods of mining, of copper mining, and of course we have gone now through a period of time where the copper market itself has declined dramatically. So Butte's population today is in the area of about 38,000 people, which represents a very significant decline.

On June 30, 1983, the whistle blew for the last time for about 1,000 employees of the Anaconda-Arco Company when they suspended their mining operations. At about the same time, we had a major distribution center close its operations in Butte, resulting in a loss of another 400 jobs. So within a year's time—much shorter than that. Within about a four month period in Butte, we lost about 1,200 basic industry jobs.

So we obviously felt that the reliance on the one industry was certainly something that was a devastating effect with us. It left us with high unemployment, it left us with physical impairments that was caused by the extraction of the copper ore, and a feeling of being abandoned in the lack of—really, a very deep frustration that obviously had to be dealt with in very serious terms.

Rather than rolling over and dying, as many people expected would happen in Butte, the people of Butte refused to accept the dark scenario that had been set for us and we set about the business of an economic recovery strategy. In summary, that strategy was to retain what already existed in Butte and to help new small businesses expand and to attract businesses by helping them start and grow.

Now, we recognized that, at least for the short term, small business was the key to stabilization of the Butte economy. One of the advantages that we had in Butte, of course, is being strategically located as far as transportation is concerned. Montana is a State rich in natural resources and rich in agriculture, and Butte is fortunate to be on the hub of an interstate, two interstate highways, I-90 and I-15.

We are also the only community in the State of Montana that is serviced by two major rail carriers, the Burlington Northern and the Union Pacific.

And we took advantage of that strategic location by coming forth in the State of Montana with a new innovative approach to shipping commodities from Montana. And we developed, with the help of the State and the Federal Government, a major grain terminal facility which allows shippers of grain and barley and growers of grain and barley to ship their commodities to Butte by truck and then have them transloaded and shipped to new markets.

That has done a number of things for us. It has opened up new markets for Montana commodities and it has created a number of jobs for Butte workers as well.

In addition to that, we have now developed a lumber transloading facility utilizing this same basic premise, and we are now in the process of developing with the State of Montana a major hub facility that will create several hundred jobs in the Butte area within the next year.

Perhaps one of the best examples in the country of developing a community's assets was the development of the mining properties that had been closed by Anaconda by a company called Montana Resources, which was a small company owned by an entrepreneur from Missoula, Montana.

Mr. Dennis Washington, the owner of that company, purchased the mining properties in Butte and reopened the copper mining facilities in that community as a small business enterprise. And it is a small business enterprise. There is 350 employees, as compared to Anaconda's 1,000 employees, and they are mining the same level of production as 1,000 employees were doing, with one-third the number.

They have cut the cost of operations by over 50 percent and they are today operating at a profit. That has added another $20 million of payroll and goods, purchases of goods and services, to our community, which has resulted in a number of new small businesses being able to re-establish themselves in the community.

In addition to that, we have created a small business development center in Butte, utilizing EDA, local government, SBA funds, and a number of other State and private funding sources. We have created eight new businesses in that facility since the 1st of January of this year.

We are obviously moving into some other areas as well. Taking advantage of our strategic location in regard to our elevation and in regard to our cool winter weather, we are developing a high altitude training facility for Olympic competition. That facility is now under construction, and the community is in the process of raising $6.5 million privately to construct that facility.

It will be a major facility, employing upwards to 200 people in direct and indirect jobs, and we expect that to be a center that will attract national teams from all over the world to train for the 1988 Olympics and other winter games throughout the country.

We are also involved in the development of a psychiatric facility for adolescents. That psychiatric facility for adolescents will create some 100 new jobs in the community within the next year.

So basically, we have lost some 1,200 jobs in the Butte community. Our goal is to restore those through small business development, and we are having a great deal of success. We are at about 80 percent of the goal right now. Within two years we will hopefully have reached our goal of replacing those 1,200 jobs.

One of the main points that I want to make here this morning, however, that small business expansion and development is what has kept Butte from slipping into the obscurity that many people predicted for it. Many small businesses have been able to grow and prosper in an economy that was not conducive to growth.

However, they would not have been able to do this without assistance of what I call the public-private partnership. Senator, I want to emphasize this morning the importance of the public aspect of this. It was EDA, it was SBA, it was the CDBG block grant program, it has been the job training programs that have been available to our community, and now hopefully an urban development action grant, that are going to keep these small businesses alive and keep them well.

That is the important point that I want to make. It is, you have to have that public-private partnership and the public partnership has to have those basic tools that are available to us today.

We have had some success in Butte, but we have not gone far enough. We are going to be entering into a new phase of developing our economy, and we call this the industrialization phase of our economy.

And we are going to be looking at adding value to Montana products. The State of Montana, as you know, Senator, has a history of allowing its natural resources to be exploited, leaving the State with a negligible tax base. Our timber, our minerals, our cattle, and our agricultural products for the most part have been shipped out of the State for processing.

Our new goal is now to develop small industries that would add value to some of these resources before exporting them.

In order to choose that, however, we need the public-private partnership to continue, it is absolutely essential. In Butte, we have proven that it works, and we want now to build on those new and innovative approaches and develop not only Butte but the entire State of Montana.

Thank you.

[The prepared statement of Mr. Peoples follows:]

NEW PERSPECTIVES ON THE RURAL ECONOMY

U.S. SENATE COMMITTEE ON SMALL BUSINESS

TESTIMONY BY

DONALD R. PEOPLES, CHIEF EXECUTIVE

BUTTE-SILVER BOW, MONTANA

MARCH 5, 1987

BUTTE, MONTANA HAS A UNIQUE HISTORY. IT MAY BE ONE OF THE FEW COMMUNITIES IN THE UNITED STATES THAT HAS UNDERGONE THE TRANSITION FROM A METROPOLITAN AREA TO A RURAL AREA.

COPPER MINING WAS RESPONSIBLE FOR THE GROWTH OF BUTTE INTO A HETEROGENEOUS COSMOPOLITAN URBAN CITY. IN 1920, BUTTE BOASTED A POPULATION OF 60,000 INHABITANTS MAKING IT ONE OF THE LARGEST CITIES IN THE NORTHWEST. APPROXIMATELY 12,000 MINERS WERE EMPLOYED IN THE UNDERGROUND MINE TUNNELS AT THE PEAK OF OPERATIONS. SINCE THE 1930'S, BUTTE'S ECONOMY AND POPULATION HAVE FOLLOWED THAT OF THE COPPER INDUSTRY IN A STEADILY DECLINING TREND. THE UPS AND DOWNS OF THE COPPER INDUSTRY WERE REFLECTED IN BUTTE'S BOOM AND BUST ECONOMY.

THE RECESSION IN THE UNITED STATES COPPER INDUSTRY WAS, IN TURN, RESPONSIBLE FOR BUTTE'S POPULATION DECLINE RESULTING IN ITS NOW BEING CLASSIFIED AS A RURAL AREA. THE 1980 CENSUS FOR BUTTE-SILVER BOW WAS 38,092. THIS IS A 37% POPULATION DECREASE SINCE 1920.

IN 1955, THE ANACONDA MINERALS COMPANY BEGAN OPEN PIT OPERATIONS AT THE BERKELEY PIT WHICH CONSUMED THIRTY-FIVE OF THE UNDERGROUND MINES AND A PORTION OF THE CITY ITSELF. IT WAS THE LARGEST TRUCK OPERATED OPEN PIT MINE IN THE UNITED STATES. THE PERIOD

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FROM 1950 - 1980 SAW CHANGES IN MINING TECHNOLOGY THAT COUPLED WITH A DEPRESSED WORLD COPPER MARKET AND INCREASED PRODUCTION COSTS, CAUSED SIGNIFICANT CHANGES IN BUTTE'S PRIMARY INDUSTRY. MOST OF THE UNDERGROUND MINES CLOSED DURING THIS TIME WITH THE LAST ONE, THE KELLEY, CEASING OPERATION IN 1982. ON JUNE 30, 1983, THE ANACONDA MINERALS COMPANY SUSPENDED ALL MINING OPERATIONS IN BUTTE.

BUTTE FELT THE PAINFUL REALITY OF BEING DEPENDENT ON ONE INDUSTRY. WE WERE LEFT WITH HIGH UNEMPLOYMENT, THE PHYSICAL IMPAIRMENTS CAUSED BY THE EXTRACTION OF THE COPPER ORE AND A FEELING OF BEING ABANDONED. THE LACK OF ECONOMIC DIVERSIFICATION MADE THE BLOW DOUBLY HARD TO ACCEPT. LIKE MOST SMALL CITIES IN RURAL AMERICA, SURVIVAL REPLACED THE ONCE ASSUMED GOAL OF GROWTH. MEDIA REPORTS WERE PREVALENT DESCRIBING THE DEATH OF BUTTE AND PREDICTING IT WOULD SOON BE LITTLE MORE THAN A DECAYING GHOST TOWN.

HAPPILY THE BUSINESS, CIVIC AND GOVERNMENTAL LEADERS OF BUTTE-SILVER BOW REFUSED TO ACCEPT THIS DARK SCENARIO AND SET OUT TO DEVELOP AN ECONOMIC DEVELOPMENT STRATEGY WITH IMMEDIATE, INTERMEDIATE AND LONG RANGE GOALS. OVER 250 COMMUNITY LEADERS REPRESENTING EVERY SECTOR OF THE ECONOMY TOOK PART IN THIS PLANNING PROCESS. THIRTEEN DIFFERENT AREAS OF THE LOCAL ECONOMY WERE STUDIED AND STRATEGIES DEVELOPED. IN MANY RESPECTS ALL THE STRATEGIES WERE CONCERNED WITH EXPLOITING AND RETAINING WHAT ALREADY EXISTED IN BUTTE, HELPING EXISTING SMALL BUSINESSES TO EXPAND, ATTRACTING NEW BUSINESSES AND HELPING THEM TO START

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AND GROW. BUTTE RECOGNIZED THAT AT LEAST FOR THE SHORT TERM, SMALL BUSINESSES WERE THE KEY TO STABILIZATION AND ANY GROWTH OF ITS ECONOMY. WHILE IT MIGHT HAVE BEEN NICE TO DREAM OF A FORTUNE 500 COMPANY COMING IN AND SOLVING ALL OUR ECONOMIC PROBLEMS, IT WASN'T GOING TO HAPPEN.

DEVELOPMENT WOULD ONLY OCCUR WHEN WE RECOGNIZED OUR STRENGTHS AND EXPANDED UPON THEM. ONCE THE PLAN WAS IN PLACE AND THERE WAS A COMMUNITY CONSENSUS OF THE STRENGTHS AND THE STRATEGIES TO BE FOLLOWED, PLANS WERE IMPLEMENTED TO FORGE AHEAD ON PROJECTS.

ONE OF BUTTE'S ADVANTAGES IS THAT IT IS AT THE CROSSROADS OF TWO INTERSECTING INTERSTATE HIGHWAYS AND IS SERVICED BY TWO MAJOR RAILROADS. IN FACT, IT IS THE ONLY CITY IN MONTANA WITH ACCESS TO A SOUTHBOUND RAILROAD, THEREFORE, TRANSPORTATION DEVELOPMENT MADE GOOD SENSE. BY BUILDING ON THIS ASSET, THE PORT OF MONTANA AND LOCAL GOVERNMENT WORKED TO DEVELOP A UNIT TRAIN GRAIN SUBTERMINAL AND LUMBER TRANSLOAD FACILITY, AND ARE NOW WORKING TO EXPAND THIS CONCEPT TO OTHER MONTANA COMMODITIES WITH THE DEVELOPMENT OF A COMPLETE TRANSPORTATION HUB FACILITY. THESE SMALL BUSINESSES WILL CREATE APPROXIMATELY FORTY DIRECT JOBS AND TWICE AS MANY INDIRECT JOBS. IN A RURAL COMMUNITY, THIS HAS A SIGNIFICANT IMPACT ON THE ECONOMY.

PERHAPS ONE OF THE BEST EXAMPLES IN THE COUNTRY TODAY OF DEVELOPING A COMMUNITY'S ASSETS AND OF THE ABILITY OF SMALL BUSINESS TO BE A MAJOR FACTOR IN ECONOMIC DEVELOPMENT IS MONTANA RESOURCES, INC. THE BUTTE HILL IS STILL RICH IN COPPER AND MOLYBDENUM, BUT AS I SAID PREVIOUSLY, THE ANACONDA MINERALS

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COMPANY SUSPENDED ITS COPPER MINING OPERATIONS IN BUTTE IN 1983. THIS GIANT CORPORATION COULD NOT OPERATE PROFITABLY IN THE WORLD'S COMPETITIVE COPPER INDUSTRY. WHY THEN WOULD A SMALL BUSINESS ENTREPRENEUR THINK HE COULD SUCCEED WHERE ANACONDA/ARCO FAILED? DENNIS WASHINGTON FROM MISSOULA, MONTANA BOUGHT THE ANACONDA MINERALS COMPANY'S PROPERTIES AND INCORPORATED MONTANA RESOURCES, WHICH IS SUCCEEDING IN OPERATING MORE EFFICIENTLY. MONTANA RESOURCES PRESENTLY EMPLOYS 306 PEOPLE IN BUTTE. THEY OPERATE WITH MULTI-SKILLED EMPLOYEES AT ALL LEVELS, AND HAVE ELIMINATED THE HIGH CORPORATE OVERHEAD THAT PLAGUED THE BIG CORPORATION. THE RELAXED SMALL BUSINESS ATMOSPHERE AND PEOPLE ORIENTED MANAGEMENT INSTILLS A MUCH HIGHER LEVEL OF PRODUCTIVITY WHICH HAS RESULTED IN THE PROCESSING OF AS MANY TONS OF ORE AS THE ANACONDA MINERALS COMPANY WAS PRODUCING WHEN IT CLOSED WITH HALF THE NUMBER OF EMPLOYEES. EVEN AT TODAYS DEPRESSED METAL PRICES, THIS SMALL COPPER PRODUCER IS COMPETING SUCCESSFULLY IN THE WORLD MARKET WITH GIANT CORPORATIONS AND GOVERNMENT SUPPORTED FOREIGN PRODUCERS. IT IS AN EXCELLENT EXAMPLE OF WHAT A SMALL BUSINESS CAN ACCOMPLISH.

AS A DIRECT SPIN-OFF FROM THE RESUMPTION OF MINING IN BUTTE, A SMALL BLASTING POWDER MANUFACTURER HAS MOVED TO THE COMMUNITY. THEY ARE OPERATING OUT OF THE NEWLY OPENED BUSINESS DEVELOPMENT CENTER, WHICH WAS CREATED SPECIFICALLY TO ENCOURAGE AND ASSIST THE FORMATION OF NEW BUSINESSES. THE BUSINESS DEVELOPMENT CENTER WAS MADE POSSIBLE BY UTILIZING EDA, LOCAL GOVERNMENT, STATE AND PRIVATE FUNDING SOURCES. IT OPENED IN DECEMBER, 1986 AND ALREADY THERE ARE SEVEN SMALL BUSINESSES OCCUPYING THE BUILDING

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WITH FOURTEEN NEW JOBS.

BUTTE'S CLIMATE HAS OFTEN BEEN SEEN AS A MAJOR DISADVANTAGE, HOWEVER, ONE KEY TO ECONOMIC SUCCESS IS TURNING YOUR PERCEIVED WEAKNESSES INTO STRENGTHS. BUTTE'S HIGH ALTITUDE AND COLD CRISP WINTER AIR MAKE IT AN IDEAL SETTING FOR TRAINING WORLD CLASS ATHLETES - THUS THE DEVELOPMENT OF THE U.S. HIGH ALTITUDE SPORTS CENTER SPECIFICALLY DESIGNED TO TRAIN U.S. OLYMPIC SPEED SKATERS. IT IS THE ONLY HIGH ALTITUDE TRAINING FACILITY OF ITS KIND IN THE UNITED STATES. WHEN COMPLETE, THIS FACILITY WILL EMPLOY APPROXIMATELY 20-24 PEOPLE, HOWEVER, THE SECONDARY IMPACTS ON THE SERVICE RELATED INDUSTRIES WILL BE FOUR-FIVE TIMES THAT AMOUNT DUE TO THE NUMBER OF U.S. AND FOREIGN SKATERS, COACHES, SPECTATORS AND MEDIA PERSONNEL THIS FACILITY WILL ATTRACT. IT STARTED WHEN ONE PERSON HAD A VISION AND REALIZED THAT BUTTE'S CLIMATE AND ELEVATION COULD BE AN ASSET.

THERE ARE NUMEROUS OTHER SMALL BUSINESSES THAT HAVE EXPANDED AND DEVELOPED HELPING TO STABILIZE THE ECONOMY. RIVENDELL CORPORATION, FOR EXAMPLE, IS IN THE PROCESS OF CONSTRUCTING A YOUTH PSYCHIATRIC TREATMENT CENTER THAT WILL CREATE 100 NEW JOBS. THEY CHOSE BUTTE IN PART DUE TO ITS CENTRAL LOCATION AND IN PART DUE TO THE COOPERATIVE EFFORTS OF THE BUTTE LOCAL DEVELOPMENT CORPORATION AND THE LOCAL GOVERNMENT. IT WAS IN FACT A COMMUNITY PARTNERSHIP.

ONE OF THE MAIN POINTS I WISH TO MAKE IS THAT IT WAS SMALL BUSINESS EXPANSION AND DEVELOPMENT THAT KEPT BUTTE FROM SLIPPING INTO THE OBSCURITY PREDICTED FOR IT. MANY SMALL BUSINESSES

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HAVE BEEN ABLE TO GROW AND PROSPER IN AN ECONOMY THAT WAS NOT CONDUCIVE TO GROWTH. HOWEVER, THEY WOULD NOT HAVE BEEN ABLE TO DO THIS WITHOUT ASSISTANCE. PUBLIC/PRIVATE PARTNERSHIPS HAVE BEEN ESSENTIAL TO SMALL BUSINESS DEVELOPMENT IN BUTTE. WHETHER IT WAS THROUGH TAX INCENTIVES, LAND ASSEMBLAGE, THE PROVISION OF PUBLIC INFRASTRUCTURE, INDUSTRIAL DEVELOPMENT BONDS, THE USE OF FEDERAL GOVERNMENT PROGRAMS SUCH AS THE SBA AND EDA OR THROUGH THE ADVANTAGES OFFERED BY THE SMALL BUSINESS DEVELOPMENT CENTER, THE LOCAL AND STATE GOVERNMENTS HAVE TAKEN AN ACTIVE ROLE IN ENCOURAGING AND ASSISTING THE SMALL BUSINESS WHO, IN TURN, HAVE PROVIDED STABILITY AND DIVERSIFICATION TO THE ECONOMIC BASE. IT IS IMPORTANT TO REMEMBER THAT SMALL BUSINESS IS RESPONSIBLE FOR OVER 900,000 NEW JOBS IN THE UNITED STATES EACH YEAR. THIS GROWTH MUST BE FOSTERED. PUBLIC/PRIVATE PARTNERSHIPS ARE ESSENTIAL IF SMALL BUSINESSES ARE TO DEVELOP AND PROSPER IN RURAL AMERICA.

EVEN THOUGH WE HAVE HAD A DEGREE OF SUCCESS IN BUTTE, WE REALIZE OUR EFFORTS DO NOT GO FAR ENOUGH. LIKE MOST RURAL COMMUNITIES WHERE THERE HAS BEEN A HISTORY OF DEPENDENCE ON ONE INDUSTRY, RECOVERY IS SLOW AND DIFFICULT. BUTTE'S UNEMPLOYMENT RATE REMAINS HIGH AND WE FULLY REALIZE THAT WE CANNOT ABANDON OUR EFFORTS TO DIVERSIFY AND EXPAND OUR ECONOMIC BASE.

WE NOW SEE A NEW DAY OF CHALLENGE APPROACHING. THE LOCAL GOVERNMENT HAS DONE JUST ABOUT ALL IT CAN DO TO PROMOTE ECONOMIC DEVELOPMENT THROUGH GOVERNMENT FINANCED INFRASTRUCTURE AND OTHER SUPPORT. NOW THERE IS A NEED FOR INDUSTRIALIZATION THAT WILL GIVE VIABILITY TO THE ECONOMY. WE'RE NOT ADVOCATING LARGE AUTOMOBILE

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MANUFACTURING PLANTS, BUT RATHER SMALL MANUFACTURING PLANTS THAT EMPHASIZE DOWN-LINE, VALUE-ADDED PRODUCTS FROM THE RAW RESOURCES PREVALENT IN SOUTHWEST MONTANA.

THE STATE OF MONTANA HAS A HISTORY OF ALLOWING ITS NATURAL RESOURCES TO BE EXPLOITED, LEAVING THE STATE WITH A NEGLIGIBLE TAX BASE. ITS TIMBER, MINERALS, CATTLE AND AGRICULTURAL PRODUCTS ARE FOR THE MOST PART SHIPPED OUT OF STATE FOR PROCESSING.

OUR GOAL NOW IS TO DEVELOP SMALL INDUSTRIES THAT WOULD ADD VALUE TO SOME OF THESE RESOURCES BEFORE EXPORTING THEM. A PERFECT EXAMPLE WOULD BE THE DEVELOPMENT OF A BEEF PROCESSING PLANT. IN ORDER TO ACHIEVE EVEN A PORTION OF THIS GOAL, PUBLIC/ PRIVATE PARTNERSHIPS WILL BE ESSENTIAL. IN BUTTE, WE'VE PROVED THAT THEY WORK, NOW WE WANT TO BUILD ON THEM IN NEW AND INNOVATIVE WAYS THAT WILL BENEFIT NOT ONLY BUTTE, BUT THE STATE OF MONTANA.

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Senator BAUCUS. Thank you very much, Don.

Mr. Stringham, why don't you proceed next and tell us about Utah.

STATEMENT OF DON A. STRINGHAM, CHIEF EXECUTIVE OFFICER, GENEXUS, INC., UTAH INNOVATION CENTER, SALT LAKE CITY, UT

Mr. STRINGHAM. I have to preface my remarks with an apology. I mailed in a statement that I hoped would be in front of you to simplify my remarks. I do not know what happened. I verified that it was mailed.

Senator BAUCUS. Well, we will find it and we will get it in.

Mr. STRINGHAM. Let me raise the sight beyond just what has happened in Utah, because it has been foisted upon us to lead a national initiative in the creation of Innovation Centers.

Originally the Utah Center was formed under a grant from the National Science Foundation as one of nine experiments in helping universities develop the wherewithall to deal with industry in the transfer of high technology. When the austerity programs from Washington took their toll, all nine failed. They were nonprofit initiatives.

That is when I entered the fray. I am a tax attorney by training, and Dr. Wayne Brown who was the Dean of the Engineering School there was a client. We simply accepted the challenge to convert a nonprofit initiative to a for-profit activity.

We did not intend to expand. We merely built substantial facilities in Research Park at the University of Utah, and as the National Science Foundation flooded us with inquiries—as the only surviving experiment—we began to look at this problem rather carefully, and in the last 2 years have expanded our operations throughout the country.

We have centers in everything from major urban areas to very rural, and since our emphasis is on that facet today I will try to limit my remarks to those smaller centers. Let me paraphrase quickly, though, a talk which I will see is available through staff, if you desire, given by Dr. Fred Davison who is the outgoing president of the University of Georgia. He spoke at Iowa State University last February.

After outlining the changing realities in the rural economy and, for that matter, America's place in the competitive context, he said: "So where is the next generation of comparative advantage going to be found? For the United States that advantage increasingly seems to lie in a combination of knowledge creation and technology transfer, and in the removal of barriers that impede this process." It is to that process to which I would like to address my remarks, the removal of barriers to the transfer process.

First off, it is important I think that we keep in context why this process is occurring now as opposed to even in more recent history in this country. Frankly, one of the major motivators is the drying up of the easy money from Washington. The researchers cannot simply keep submitting proposals and keep their work going. They also cannot make that deficit up at the local level, so they are having to learn to deal with industry.

Dealing with industry requires an entirely new set of skills and attitudes at the institutional levels. First off, for example, they have to learn to keep score in a different way. If you are someone who believes primarily in the shoving back the frontiers of knowledge and you find your ego satisfaction in publishing and in the respect of your peers, that sort of thing, you find it difficult to see how "capitalist warmongers" can be so crass as to keep score merely by how much money they are creating.

Well, we believe that bringing these two groups together is a major challenge, but it seems to be working. Universities, for example, have to develop entirely new policies and procedures to allow them to more comfortably deal with industry. If you are going to be drummed out of the faculty, ostracized, et cetera, because you do something so gauche as earn a dollar, it squelches entrepreneurship. I do not say that even facetiously.

At our own home institution, all of the great successes that have been enjoyed at the University of Utah for the first probably 15 years of this experiment, the University never shared in one dime of income. They were not part of the process. They opposed faculty entrepreneurship, and anything that happened really happened in spite of that attitude.

Well, that has changed dramatically. As a result, they have encouraged faculty entrepreneurship at every level, and the university is now sharing generously in all that is being created. There is in fact in some institutions a genuine reaching out to industry, and it takes an interesting form. Probably the single most important ingredient is for the universities to add an industrial interface role. If it is just tacked on to the other duties, some busy professor, or some busy administrator, it is not going to happen. Yet, interestingly enough, most universities do not have any money available for that purpose.

I would urge as part of my statement that a logjam breaking kind of infusion of public money could take that form in helping every institution finance the early stages of a technology transfer program by bringing into that setting an individual with wide industry experience, and who is not encumbered with any other responsibility except that. I can say from our own experience that without exception at every institution in this country where we are dealing, there is a direct correlation between the existence of that function and their current successes.

If this role is tacked on, it does not happen. If somebody focuses on that need, it can become a self-sufficient function in a great hurry. Universities need to learn to deal with industry and they need people who understand both worlds. There typically is no money available for the industrial interface purpose.

A couple of correlaries, before I turn to several very specific examples in rural settings. We do not believe more research is the problem, but really more help with the commercialization of the technology which is already occurring. The amount of money going into basic research is horrendous in this country. It is mammouth. But the amount of money directed at helping something happen to commercialize the results of that research is almost nonexistent. We think that would be a very, very critical need to address.

Properly functioning Innovation Centers serve as magnets and, as the gentleman from Butte indicated, this is home-grown industry at its best. This is not job stealing from other communities. This is creating jobs out of whatever ingredients are uniquely good in the local setting.

The classic entrepreneur, someone with a fire in his belly as it is sometimes said, does not usually exist in the business we are doing. Interestingly enough, they do not come and say I want to leave a university, I want to leave a Federal lab, I want to leave my job and start a business. Quite the contrary. They like the security of where they are. But somebody has to take the bull by the horns and see that something concrete happens out of that idea.

We found, interestingly enough, in our experiments that you typically have to provide not only all the business components to go with the technology, but you typically also have to find a champion. That professor wants to be a professor. That bench scientist is good at what he does, and unfortunately we seem to be trying to foist on him roles that he is not prepared to perform.

Lastly, in our view the continued simple dissemination of information about available technology does not work. I have listened to hundreds, literally, of people, patent attorneys, technology transfer individuals on staffs of national laboratories and universities, and to simply tell the world what is available does not work. They do not come. They are not comfortable in trying to deal with the institutions, and what we have to do is somehow figure out a way to get academics and bench scientists and technologists together with business types.

Let me in the interest of time simply cite two examples among literally hundreds. We have had I would guess something over 2000 delegations come to our university, our home base, from some 40 foreign governments, from I suppose representatives of most of the major universities, and lots of small ones, and from government at every level from Washington down through State government, Governors, their State economic development directors, and I think what I am saying is a fair distillation from what has been an absolutely overwhelming level of inquiry.

I should note that our experience runs the gamut from research universities with budgets in excess of $700 million a year, which is a staggering sum at one university, to universities who do not have one dime of research money coming in from industry. It is a profound contrast.

Senator BAUCUS. I am sorry? What was that point again? I missed it.

Mr. STRINGHAM. I said our exposures have run the gamut from research universities in this country who have upwards of $700 million annual budgets just for research that is funded from Government and private industry sources, to institutions that do not have a dime of that kind of money.

Now in spite of that wide spectrum, we still can draw some generalities. For example, the University of Georgia at Athens hired a former astronaut who has a Ph.D. in biochemistry. He was hired with the specific mandate to get an industrial interface program going.

Inside of less than 2 years, they have a viable program, a research park is going in, incubators are now under construction. It is staggering the level of interest and the depth of talent that is being tapped simply by the creation of a program.

Now as an adjunct of that particular university effort, they turned to their agricultural experiment station in Tifton, GA, which also happens to be the home of the Gulf Coast Agricultural experiment Station from the Federal Government. Let me read quickly a description of the community. It is classic to what we are addressing here today. This was written by one of my colleagues after his first site visit.

> Tifton is a classic of the American agricultural scene. It has been an area of high agricultural activity for many years. The cash crops which sustain the area were soybeans, cotton, corn, cattle, and so forth. With the recession that has hit the agricultural economy, they have seen land prices drop, farm foreclosures, total income of the area plummet, and business in their community drop off drastically. These people are far-sighted and understand that they do have resources, however, in their area; but it is going to take an organized community effort to make new things happen.

Well, what happened is, with some leadership from the mother institution, from the University of Georgia, in less than six weeks they have gotten organized. We believe there will soon be an Innovation Center in their community. They have raised over $1 million from people who originally said they did not have a dime to work with.

Tifton, GA, is a typically depressed, rural area. The business community, however, has now focused on the problem—and I mean in weeks, not years, weeks! The Innovation Center at Tifton will concentrate initially on agricultural-related products and research, of which there is a great deal. They simply turned inward and looked at what they were doing, and quit complaining about the farm jobs which are nonexistent and the young people who are leaving.

We would fully expect that within——

Senator BAUCUS. How large is Tifton?

Mr. STRINGHAM. Tifton is a very rural community. There are probably 20,000 people in the whole area.

Senator BAUCUS. And how far away is the nearest town of 50,000 population?

Mr. STRINGHAM. I cannot tell you that. I am from Utah, and Georgia itself is a long way from home. But we are impressed with the speed at which the process can occur if you create the ingredients of what we term an "entrepreneurial culture," a "can-do" attitude.

I would guess—I was just commenting on a surmise of what might happen—I would guess that within less than a year period from start to fruition that they will have a director, they will have a strong infrastructure tie to all of the interested groups in the area. The fairly modest level of leadership that the University of Georgia has provided in the past is quite adequate to get them organized. And if we do not create a constant stream of new businesses out of there, I will eat my hat—capitalizing only on what they are good at already, providing the business tools, and so forth, not trying to move in some major company.

Now that is not to say that will not occur, because at Athens, GA, we have horrendously strong interest—we would guess there might be a million square feet of new space built within the next 2 years just to house the companies who want to be close to what is going on down there. A year ago, none of this even existed. That is rural America at a classic level.

Now let me turn to an example closer to home, the Utah State University.

Senator BAUCUS. If you could, briefly.

Mr. STRINGHAM. Certainly. Utah State University is a land grant college. They not only lost population and students, the university was drying up with talk of closing it. Well, with the result of one man's effort, the research vice president with his drive, he overcame all the traditional oppositions and turf battles about universities getting into economic development, all the issues of remoteness, they do not even have a commercial air carrier into the community, a past history of people leaving in anger—if you want to be an entrepreneur, then leave the faculty, and there is nothing else for them in town and they have to leave.

At the same time, realizing that their students had a very strong homing instinct. Young people leave rural Cash County but would love to come back if there was something relevant for them to do. The university started with a 35-acre experiment and only one 15,000 foot building, and now there is over 100,000 in the planning stages less than a year later.

They have created enough businesses to fill their little incubator immediately, and a long waiting list of others wanting to use these next buildings when they come on the scene. They are creating businesses at a pace you would never believe by providing the business ingredients: A little money, and as we term it, "lots of love and attention, and a little bit of money." We have told their story on the outside to the venture capital industry who are coming in there, as inconvenient as it is, and we see not just a hotbed, we see an explosion occurring at a very rural university setting.

The key ingredient, sort of irreducible minimums, I would end with that observation. We think that this process is duplicatable in every community where they can satisfy seven requirements:

A supportive governmental structure. If they are all fighting with each other, there is no sense kidding ourselves. We have encountered that over and over. The power groups in the communities do not even deal with each other, so outsiders do not have a prayer.

You have to have some source of ongoing technology, not just one or two ideas but a foment, if you will.

You have got to have an incubator. There has got to be a place, a visibility created and a convenient place to begin this process.

There has got to be a little operating money from the communities, the kind of resources the gentleman from Montana indicated are ideal.

You have got to have some seed money for companies. It does not take very much. It is amazing how little money will go a long way if you create the right environment.

You have got to have some business talent. Just the ability to identify people with entrepreneurial talent to link with folks with technical ideas.

Then lastly, is what gave rise to our organization. The need for some sort of linkages to the outside world, a way to fill all those needs that you cannot create locally. Our guess is that within a two-year period, we will probably have 15 to 20 of these Centers functioning around the country linked to each other and augmenting each other's efforts.

It is absolutely astounding the numbers and diversity of the types of companies that are being created by creating the linkages between the university community and the business community.

[The prepared statement of Mr. Stringham follows:]

OUTLINE OF THE REMARKS OF DON A. STRINGHAM, C.E.O. OF GENEXUS, INC. BEFORE THE COMMITTEE ON SMALL BUSINESS/UNITED STATES SENATE REGARDING INSIGHTS GAINED IN THE DEVELOPMENT OF A NUMBER OF REGIONAL INNOVATION CENTERS, INCUBATORS, TECHNOLOGY PARKS, A NATIONAL NETWORK TO LINK THESE ACTIVITIES AND IN DEVELOPING ALLIANCES AND COLLABORATIONS

I. REPORT AND BACKGROUND DISCUSSION

A. Description of how the Genexus program works:

1. Genesis of the project
2. Evolutionary process - still progressing
3. Expansion imposed on us - not sought
4. Adapted to local circumstances
5. Clear narrowing of focus by Genexus
6. Emerging significant collaborations

B. Key Issues:

1. For-profit vs. non-profit
2. Government vs. private
3. Incubator vs. Innovation Center
4. Early funding
5. Ongoing funding

C. Reactions encountered from everyone:

1. Federal government
2. State government
3. Local government
4. University administrations
5. University faculty
6. Local industry

D. Funding:

1. Always been a problem - explain why
2. Sources
3. Types of funding needed

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E. Anticipated impact on local economies:
   1. Long range nature of project - prototypes
   2. Role of small business - overall
   3. Diverse experience
   4. Creation of an "entrepreneurial culture"
   5. Encouragement of a "can do" attitude

F. What political support needed:
   1. "Fragile" businesses
   2. Need constant encouragement
   3. Everyone "badmouthing" (turf defending)
   4. Tendency to "study" matter and "write reports"
   5. Hung up on RFQ and RFP processes
   6. Deeply entrenched programs to "steal" jobs vs. create jobs (i.e., home-grown industry)

QUOTE FROM DR. FRED C. DAVIDSON, FORMER PRESIDENT OF THE UNIVERSITY OF GEORGIA

"In the emerging global economy, America's competitive strength will not be based on cheap natural resources or low cost manufactured goods. In energy, minerals, basic chemicals, metals, fibers, and even food production, the reality is that our nation can no longer compete with cheaper sources of supply developing in the international marketplace.

Our country's automatic market dominance in almost every form of light and heavy manufacturing is in the past. And fiscal realities, together with the world's use of the dollar as the basic revenue medium, make it clear the cheap currency cannot be used to maintain an American advantage in a competative world. Nor does protectionism provide the solution for this challenge to our economic and political leadership.

The urgency of the situation is made even more clear by the pressures of an enormous world population growth, depletion of petroleum resources and the limited capacity of fuel and fiber systems based on petroleum. These tell us that innovative approaches are critical, quite literally, to our survival.

So where is the next generation of comparative advantage to be found? For the United States, that advantage increasingly seems to lie in a combination of knowledge creation and technology transfer, and in the removal of barriers that impede this process."

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SUGGESTED USE OF GOVERNMENT FUNDING SOURCES

"PUMP PRIMING"
FUNDING HELP IN GETTING ORGANIZED
FUNDING HELP IN ESTABLISHING INNOVATION CENTER

PROVIDING FUNDS TO OPERATE INCUBATOR AND PROVIDE SUPPORT SERVICES

LEASING SPACE TO HOUSE "START-UP" FUNCTIONS

PROVIDING "SPECIALIZED" FACILITIES

"ON-SITE" PRESENCE BY RELEVANT AGENCIES

FUNDING EDUCATIONAL EFFORTS

PROVIDING LOW INTEREST LOANS

PROVIDING VERY EARLY STAGE "SEED MONEY"

PROVIDING STATE FUNDED "SBIR" PROGRAMS

BETTER ASSISTING OF THE "99 OUT OF 100" NEW BUSINESSES IDENTIFIED YET NOT SERVED BY THE FOR/PROFIT INNOVATION CENTER

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Questions and answers, Senator Pressler to Mr. Stringham

RURAL ECONOMY AND FAMILY FARM SUBCOMMITTEE
MARCH 5, 1987

1) THERE HAS BEEN A GREAT DEAL OF PRESS ATTENTION RECENTLY ON THE AGRICULTURAL ECONOMY. IN YOUR VIEW DO YOU FEEL THAT THE PRESS HAS DEPICTED THE PROBLEM AS IT REALLY IS?
Yes, but, as always, they tend to sensationalize.

IF NO:

WHY NOT?

DO YOU FEEL THE PRESS ATTENTION HAS HELPED AMERICANS LIVING IN MORE URBAN AREAS TO BETTER UNDERSTAND THE DRASTIC NATURE OF THE SITUATION?

Yes

2) MANY SMALL BUSINESS OWNERS IN THE SMALLER COMMUNITIES OF SOUTH DAKOTA HAVE INDICATED TO ME THAT THEIR SALES WERE DOWN 40 TO 50 PERCENT. BASED ON YOUR KNOWLEDGE OF THIS SITUATION, WOULD YOU SAY THAT ALL RURAL AREAS OF THE COUNTRY HAVE BEEN EFFECTED IN A SIMILAR FASHION?
Absolutely yes.

IF YES:

IF THESE LOW SALES CONTINUE, HOW LONG DO YOU THINK THESE BUSINESSES CAN SURVIVE? Less than five years

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QUESTIONS -- PAGE 2

3) IF THE AGRICULTURAL ECONOMY REMAINS PRETTY MUCH AS IS, WILL THE LOSS OF MAIN STREET BUSINESSES CONTINUE AT THE CURRENT PACE?

Yes, and, if anything, perhaps the pace may accelerate.

4) WON'T THE DEPRESSED ECONOMY IN SMALL RURAL COMMUNITIES SOON BEGIN TO AFFECT LARGER COMMUNITIES AND EVENTUALLY THE ENTIRE RURAL ECONOMY?

Yes.

IF YES:

HOW LONG WILL IT BE BEFORE THIS CHAIN REACTION TAKES PLACE?

The process is already beginning, in earnest.

5) IN CONVERSATIONS I HAVE HAD WITH SMALL BUSINESS OWNERS IN SOUTH DAKOTA, SEVERAL SAID THEY HAD EXPERIENCED LARGE LOSSES DUE TO FARMERS FILING BANKRUPTCY. IN YOUR VIEW, IS THIS A NATIONWIDE PROBLEM?

Yes.

DOES THIS PROBLEM AFFECT A SIGNIFICANT NUMBER OF SMALL BUSINESSES?

Yes.

IS THIS TREND INCREASING?

Yes.

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6) IF YOU HAD ONLY ONE CHOICE, WHAT WOULD BE THE SINGLE BEST THING THE SBA OR ANY OTHER GOVERNMENTAL AGENCY COULD DO TO AID SMALL BUSINESSES AND COMMUNITIES THAT HAVE BEEN HARD HIT BY THE FARM PROBLEM?

Quite obviously, there are no easy answers. However, our own experiences in developing new Innovation Centers and other related mechanisms to help capitalize on business opportunities in given communities seems, to us, to offer one of the most pressing possibilties.

The emphasis must be upon job creation and new business creation on a "home-grown" basis, rather than a "job-stealing" basis, where everyone is attempting to induce industry to simply relocate to different communities.

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Senator BAUCUS. Thank you very much, Mr. Stringham. We appreciate your upbeat optimism.

Mr. Martin.

[The prepared statement of Mr. Martin follows:]

ARROWHEAD REGIONAL DEVELOPMENT COMMISSION

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Testimony of:

David A. Martin

Executive Director

Arrowhead Regional Development Commission

Duluth, Minnesota

Before the

Subcommittee on the Rural Economy and Family Farming

Committee on Small Business

United States Senate

on

Farm Perspectives on the Rural Economy

March 5, 1987

Washington, DC

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STATEMENT BY DAVID A. MARTIN, EXECUTIVE DIRECTOR OF THE ARROWHEAD REGIONAL DEVELOPMENT COMMISSION, DULUTH, MINNESOTA, BEFORE THE SUBCOMMITTEE ON THE RURAL ECONOMY AND FAMILY FARMING OF THE COMMITTEE ON SMALL BUSINESS, UNITED STATES SENATE, MARCH 8, 1987.

Mr. Chairman, members of the Subcommittee on the Rural Economy, I am David Martin, Executive Director of the Arrowhead Regional Development Commission (ARDC) with headquarters in Duluth, Minnesota. I am also the Immediate Past President of the National Association of Development Organizations (NADO), headquartered here in Washington, DC. The Arrowhead Regional Development Commission is an Economic Development District (EDD) and a Certified Development Company under the Section 503 program of the Small Business Administration.

I appreciate the opportunity to testify before this Subcommittee concerning the problems, challenges and opportunities confronting the economic future of Rural America. On behalf of ARDC and NADO I would like to thank the members of this Subcommittee and the Committee on Small Business for your continued bi-partisan support of the programs of the Economic Development Administration (EDA) and the Small Business Administration (SBA) over the years.

Mr. Chairman, I particularly appreciate your efforts to maintain funding over the past several difficult years for those rural economic development programs that remain so vitally needed in Minnesota, Montana and all of rural America. On behalf of Economic Development Districts across the nation, commend you for the effort you are initiating today to make rural America a viable, competitive force in the new national economy we see forming.

For you information and background, I would like to briefly describe to you who the Economic Development Districts are and why NADO was formed by the Districts.

Economic Development Districts

For thousands of communities, development district staffs provide the only professional assistance to governments, businesses and citizens in the field of economic development. By working cooperatively through development districts, local governments and the private sector can maintain and create jobs with a minimum of control from Washington and maximum local participation. Development districts have become an essential part of the "institutional infrastructure" in much of rural America.

EDA planning grants provide funds to 340 development districts in 49 states for activities which assist local governments to become more efficient and help local businesses to survive and expand. Although the amount per district is very small ($250,000 average), it provides the vital professional staff capability which gives small communities access to development expertise. Now, more than ever, the districts are essential for the economic well-being of many rural local governments.

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National Association of Development Organizations

NADO was founded in 1967 by a group of economic development districts to encourage the creation and retention of jobs in rural and small metropolitan areas. Today our members are multi-county planning and development organizations and other state and local agencies which help local governments and the private sector work together on business, community, economic and rural development programs. With a small Washington staff and a strong grassroots network we carry out a number of information, training and service functions including a national conference. This past year our meeting's theme was "Rural Development: Strengthening America's Foundation".

Rural Economic Depression

The general economic recovery of the past several years has by-passed many rural areas. Preliminary results of a survey done by the Appalachian Regional Commission on the economic conditions of the nation's counties from 1970 to the mid-1980s show that a two-tier economy is developing. Their study shows that the economies of a large number of counties extending from Canada to the Gulf of Mexico are performing poorly. The urban areas of the East and West and some areas in the South are enjoying economic prosperity, but rural areas in the same regions are not faring so well.

Some of the findings in the study include:

- It is evident that the benefits of the recovery and prosperity in the United States are not being enjoyed to the same extent in all areas of the country. Some regions are clearly endowed with a higher number of better-performing counties than are other regions.

- In each region of the country, the metropolitan areas are outperforming the rural areas. The decade of the seventies saw a short-lived surge in growth in rural counties and small towns, which was a reversal of the farm-to-city movement that started at the beginning of the century. By 1980 the trend reversed and outmigration from rural areas was again the norm.

- The effect of the decline in manufacturing employment in the U.S. is markedly evident. Areas that depended on traditional manufacturing, have been shaken by the dwindling relative role of manufacturing as an employer in the U.S. economy.

In addition to the problems identified in the ARC study, there are serious problems in many of the extractive industries such as mining, timber and fishing which are located in rural areas. Except for precious and strategic minerals, the mining industries throughout the country are having major problems. In the timber industry, employment has been lost because of mechanization and export competition.

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The Present Situation in Northeastern Minnesota

As many rural areas of the country begin to suffer the effects of dramatic declines in the industries upon which they have traditionally depended, there is certain to be increased interest in - as well as need for - effective strategies for facilitating beneficial transitions in regional economies. Ideally such strategies should build upon local strengths, and supply or augment those features, essential to a dynamic economy, which may be missing or in need of development.

Northeastern Minnesota offers a particularly instructive example of both the causes and the effects of economic decline resulting from the withering of a major regional industry. This area, commonly referred to as the Arrowhead Region, is largely a rural area, covering almost one quarter (18,000 square miles) of the state's land while at the same time accounting for less than ten percent of its population. According to the 1980 census there were some 343,000 inhabitants of the region; current estimate suggest a decline of approximately 18,500 persons. Primary industries in the region are mining, forest products, and tourism. Mining, however, since the turn of the century has been by far the most significant factor in the region's economy, and its role, both historically and in the present troubled situation, calls for further elaboration.

Immediately upon the heels of the lumbering era which resulted in the clearing of vast areas of northeastern Minnesota forests, the extraction of iron ore became a major business in the region, around which many other industries, such as transportation and steelmaking, revolved. Later in the century, taconite became the mining industry's main focus, and the extraction, processing and shipping of taconite constituted by far the predominant economic activity in the area until the decline in mining activity began to accelerate rapidly in the early 1980s.

The fact that the region's economy has been so heavily dependent upon a single industry has led to especially devastating effects as a result of that industry's decline. One need only examine mining employment statistics to grasp the magnitude of these effects. From August of 1979 to December 9 of 1984, mining employment dropped from 16,650 to 3,89, a loss of 12,650 jobs. Although some of that loss has been recovered through callbacks, employment in the mining industry is still at less than half of is 1980 level, and it is believed that over 10,000 jobs in the region's mining industry may have been permanently lost. These figures pertain to direct employment in the mining industry only; in an economy such as that of the Arrowhead Region, where mining accounted in 1980 for 12 percent of regional employment and over 20 percent of total wages, this level of decline has of course had significant impact far beyond the industry itself.

For some it appears that hope for recovery lies entirely in a revival of mining activity. While it is clear that the recession of the 1980s was a major factor in the decline of the taconite industry, it was by no means the only factor. A much larger threat for the future of the industry is the increasing competition from foreign iron and steel products. Given the trend for increasing imports and reduced domestic production it is expected that

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taconite shipments from northeastern Minnesota will decrease between now and the year 2000. Thus, it appears that the decline of the taconite industry is not a temporary phenomenon, but a permanent condition.

This reduction in the mining industry, and therefore the regional economy, manifests itself in many ways beyond unemployment rates, which continually and consistently exceed state and national averages. The effect has also been felt in related industries, as well as in retail nd wholesale sales. It is estimated that the region has seen a structural reduction in its annual gross regional product of somewhere between $500 million and $2 billion. An increased number of bankruptcies, both business and personal, has been another fact of life in recent years.

Perhaps one of the most ominous results of this economic decline has been the increased rate of outmigration. As individuals, unable to find employment within the area, accept positions outside northeastern Minnesota, the region's resources, in the form of its population and labor force, are further eroded. Even more distressing, it is often the area's most "employable" individuals who are leaving. Many of those individuals who choose to stay in the area without employment are placing an additional burden on local governments at a time when their respective tax bases may be stagnant, or even declining.

This difficult and prolonged situation results not only from the fact that economic activity in the region has been so heavily concentrated around a single industry. Contributing significantly to the difficulty of adjustment is the fact that this predominant industry has been largely controlled from outside the region. Thus, upon the withdrawal of these major companies from participation in its economic life, the region is deprived of a major source of capital for economic diversification, and also of the entrepreneurial inspiration and experience which their seasoned leadership might have been able to provide.

This description of the difficulties facing northeastern Minnesota is certainly troubling enough. Yet it would be a mistake to consider it the whole picture. This is a region rich in natural resources; further, many of those individuals who have chosen to remain here have done so out of a preference for this area, and are motivated to improve both its and their own economic circumstances. Opportunities abound in the Arrowhead Region for new growth and development. The recent economic difficulties of the area have greatly increased awareness of the need to expand in value-added production based on existing resources, to diversity into new areas not commonly associated with northeastern Minnesota, to draw on a highly motivated and skilled work force, and to establish locally controlled businesses not subject to the narrow focus of an absentee owner.

Forming a New Foundation

For the past six years, local, regional, State and federal economic development programs and organizations have worked together in N.E. Minnesota to address the economic crisis. In partnership with the private sector, significant new business development has occurred which is beginning to diversify the economic base of our area. Examples of new types of businesses

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recently established in N.E. Minnesota include:

- Chopstick Factory (primary market in Japan)
- Carpet Mill
- Electronics Firm (makes the internal workings of a national electronic typewriter)
- Mock Crab Meat Manufacturer (fish from Alaska as primary ingredient)
- Promotion and Fulfillment Company (rebates, send in the label, call 800 for more information)
- Telemarketing Firm
- Raspberry Vinegar Producer (with markets all over U.S.)
- Paper Company (makes the glossy paper used for advertisement sections in Sunday newspapers)

The number one private sector area of employment in our Region now is the office sector, followed closely by both tourism and retail sales. Clearly we are an area in transition, a microcosm of the change which is occurring all over the nation.

The Tools Needed to Make the Transition

We have used every available public program to assist in developing new business in our rural area. We have needed these programs to help compensate for distressed local government budgets and funding capabilities and to make possible the investment of private dollars into an area which was considered high-risk due to its dramatic economic depression. Programs such as EDA, SBA, UDAG, and CDBG are well known in our region and have been involved in every one of the projects previously cited. Unfortunately, these programs and others which provide crucial aid to rural economies have been brutally decreased in their funding for several years in a row. It is past time to restore and expand these "investments in the future of Rural America" and I hope the Congress will rise to this need.

In addition to our utilization of public programs, we have initiated and continue to develop, new programs to address needs and opportunities in our area. Some of these programs which may be of interest to you are:

- Arrowhead Business Connection - a targeted regional marketing program aimed at developing office sector businesses. An economic adjustment strategy for our region identified the office sector as an area for which our region has distinct locational advantages. Major funding for this program has been secured from two foundations, telecommunications companies, and other private sector contributors.

- Minnesota Marketplace - an import substitution program modeled after a successful effort in Eugene, Oregon. This program focuses on increasing local purchases from within the Region by local firms. Major foundation funding has just been secured for this program.

- Federal Contract Procurement - a program designed to aid existing local firms in obtaining federal contracts through direct technical assistance. This program has been funded by the Defense Logistics Agency.

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- Northeast Ventures Corporation - a venture capital company currently under development which will be designed both to provide a significant source of venture capital for development of promising business opportunities in our area, and a "micro-fund" to provide access to financing and assistance in development of entrepreneurial skills for low-income individuals motivated to attempt self-employment ventures.

To aid us in designing and implementing these new programs we have created The Northspan Group, Inc., a non-profit affiliated organization. We felt that our business development programs could best be delivered through a private sector mechanism which would provide the kind of entrepreneurial environment and flexibility necessary to meet our changing environment. We feel we must continually strive to pursue every possible means for economic diversification and growth for our area. To do this, we must develop and maintain a competitive capability in those arenas within which we know we have the ability to compete.

The Bottom Line

The metropolitan and rural areas of this country are rapidly becoming two different worlds. The rural world in which I live and work faces unprecedented economic challenges to its survival, while 180 miles to the south the Minneapolis/St. Paul metropolitan area grows exponentially. This dichotomy is evident throughout the nation.

If we are to stop the rural decline and even start reversing it, we will need a major national commitment. Please believe me when I tell you that the commitment is already there locally and we wait for a strong, willing Federal partner to step forward.

We know that the strength of our rural area is in our people, our quality of life and in our ability to overcome adversity through ingenuity and hard work. We also know that in this time of increasing interdependence we can't do it alone. We need your help, your support, and your commitment to doing what needs to be done to meet the needs of the next century. Rural America needs to be "connected" to the metropolitan areas by the new interstate highways of our age, fiber optic telecommunications lines. We need to be the clear target of Federal economic development assistance programs; programs designed to encourage business to settle in rural America. And, as a matter of public policy, we need to emphasize the use of the infrastructure for development which is already in place in many rural areas.

Thank you for this opportunity to appear before the Subcommittee. Mr. Chairman, let me thank each of you again for your support of Rural Economic Development Programs and for your interest in new possibilities. I will be happy to answer any questions.

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STATEMENT OF DAVID A. MARTIN, EXECUTIVE DIRECTOR, ARROWHEAD REGIONAL DEVELOPMENT COMMISSION, DULUTH, MN

Mr. MARTIN. Thank you, Mr. Chairman. It is a pleasure to be here today.

In addition to being the executive director of the Arrowhead Regional Development Commission in Duluth, MN, I am also the immediate past president of the National Association of Development Organizations. In that capacity I have had a chance to meet a lot of good people that are working in economic development around the country in EDA-funded development districts, and I wanted to bring you greetings today from Tony Priete in Havre with the Bear Paw Development Council, and Mayor Don Driscolle. They said to say hello to you, and to send their greetings to you.

Senator BAUCUS. Thank you.

Mr. MARTIN. I want to do three things with my presentation today, hopefully very briefly as I know you have saved the best for last and I want to keep that confined.

Senator BAUCUS. Absolutely.

Mr. MARTIN. I want to do three things. I want to just give you a quick picture of northeastern Minnesota where I work on a daily basis to create jobs. I want to talk to you a little bit about some of the things that we have accomplished. And finally, I want to respond to a couple of the questions that you have raised about the best and the worst development programs. In addition to the three areas I had prepared to cover I want to also explain what digital switching is.

Senator BAUCUS. Oh, wonderful. [Laughter].

Mr. MARTIN. I would like to save that to last.

Senator BAUCUS. OK.

Mr. MARTIN. I would like to start out by explaining to you why I know about digital switching. That is because digital switching will be as important to my area five years from now as the Interstate Highway System was 10 years ago. Digital switching, fiber optics, that is our future. It is part of the market niche that we are looking at for our area. So that is why I know about it, and I will talk about it later.

Northeastern Minnesota has been—and by "Northeastern Minnesota" we are talking about the area North of Lake Superior, Duluth is right at the tip of it—and we have been in major economic hardship for the last 6 years, initiating with the decline in the taconite industry in our area.

In 1979 we had 16,400 people directly employed in iron mining through taconite at eight different plants in northeastern Minnesota. Employment dropped to 3,800 in 1984. This major catastrophe in our taconite industry has many causes, and I am sure you are familiar, given the copper mining situation in your own State with the closings. We have had two of our eight plants permanently closed, and of the 3,000 to 5,000 people still directly employed in mining in northeastern Minnesota, most of them are employed on an on-and-off basis, as inventories build up, and then there are long, lengthy layoffs and recalls, a continuing cycle of uncertainty.

It has totally messed up our unemployment rate calculations. Any time you look at our unemployment rate data, they are a totally inaccurate reflection of what is going on in our area because of long periods of layoff and how people are counted.

We have permanently lost at least 20,000 jobs in our area as a result just of the mining shutdown—20,000 jobs that average $20,000 per year in pay.

We were fortunate enough in the last year to have a new facility, a new paper-making facility being built in Duluth, MN, to produce supercalendared paper, which is the real shiny paper used for K-Mart and other advertisements in the Sunday section of the newspaper. That $400 million plant that will employ 200 people advertised for employees and we had 12,000 applications for the 100 jobs that were going to be available, many from people who have left our area that want to come back, many from people who are in our area who are working in jobs that they do not see having a strong future, and many from just the unemployed individuals that are in our area—12,000 applications for 100 jobs in this new papermill!

We have been significantly involved in retraining programs in the last couple of years, many of which have been directed at retraining people for jobs in other areas because we do not have the jobs they need. We have had to be involved with relocation programs helping individuals relocate from the Iron Range in our area to the Twin Cities and other locations, people who held on as long as they could, burned down all the resources of their family, and then finally recognized they would have to go elsewhere for work and needed help to get there. Through assistance from foundation's and other programs we are providing relocation programs and reconnection programs in the cities they are going to.

We are working now to develop programs for the uninsured in our area. We have somewhere between 26,000 and 50,000 uninsured individuals in Northern Minnesota. In our area we have about 320,000 people total, and we know that 75 percent of those uninsured individuals are employed—part-time or full-time—in the new kinds of jobs, many of which do not provide unemployment insurance.

Things are changing locally for us very significantly. We are transitioning from an area that was very dependent on a single industry to one that is becoming more independent and self-reliant. We have been involved in a number of different economic development programs. In my prepared remarks, I identify a number of businesses that we have been involved with bringing in to northeastern Minnesota in the last 2 or 3 years.

There is the chopstick factory that you mentioned earlier, which is located in Hibbing, MN, iron mining capital of the world, and we are shipping chopsticks to Japan. It is a market niche that is a very strong one. I do not know if you know anything about chopsticks, but we all do now in northeastern Minnesota——

Senator BAUCUS. I know they are difficult to use.

Mr. MARTIN. In addition to being difficult to use, they are disposed of after every meal. Plastic chopsticks will not be an adequate substitute for wooden chopsticks, and you need a certain kind of wood that does not splinter. So we have a certain market niche that we have been able to identify.

Senator BAUCUS. How did you find that niche? What can you provide in Minnesota, in the Duluth area, and how can you manufacture chopsticks better than other parts of the world for Japan?

Mr. MARTIN. I do not know why you can do it better. I know we have the natural resource base there in terms of the Aspen that is used for it.

Senator BAUCUS. You just found that.

Mr. MARTIN. Right. We had some entrepreneurs that were from our area who developed this entire business.

We have an electronics firm that ships three truckloads of the guts of electronic typewriters down to Texas every week; a company that could go offshore, but it is here because the people have a commitment to our area. The dollars and cents of it would probably push them offshore at some point in time, but they are committed to our area. We find it is very important to help businesses that have some reason to want to be in northeastern Minnesota. Making money, at least initially, is not always the only and best reason.

We are making crab meat. We are shipping fish in from Alaska to be made into mock crab meat in Duluth and shipped out nationally. We have a promotion and fulfillment company. When you mail box tops in for prizes or rebates, often you are mailing them to Grand Rapids, MN.

We have a new telemarketing firm. We produce raspberry vinegar, and we sell it in all sorts of shops here in Washington, DC. And we have a new paper company, as I mentioned, a $400 million facility that employs 200 people. It has a $5 million model of it that has its own building to train workers in the new plant on how to run this new giant plant that is coming into our area.

In our region, and with my organization, we have had to be extremely entrepreneurial over the last several years because of the major cuts that programs like EDA have taken. EDA programs have been cut 65 percent in the last 6 years at a time when we have needed those dollars and that assistance more than ever.

In order to afford the economic development professionals that provide assistance to the communities and to the businesses in our area my own agency has had to come up with programs that are capable of being self-supporting. We have done that, and we are continuing to work at it.

We have done an analysis of our area, put together an economic adjustment strategy with the help of the Fantis Company in Chicago, and we know that we have a real locational advantage for office sector businesses in Northeastern Minnesota.

We know that we can compete for office sector business with Chicago and Minneapolis, especially if we can have a fiber optic line connecting us to major markets. It is really no contest—if we get a fiber optic connection.

We have programs where we are looking at import substitution, substituting purchases that are made by businesses in our area from the Twin Cities and elsewhere with purchases made locally.

We are involved in Federal contract procurement, trying to secure more of the dollars that go out in Federal contracts. We are in the process of trying to form a venture capital corporation. We want to capitalize it initially at $10 million both because of the un-

availability of venture capital in our area, and also because we have a problem, as many other rural areas do, that we do not have a good deal flow. We do not have a lot of deals coming at us even when we do have programs to aid them.

So we have decided that we need to increase that deal flow. We need to have dollars that we can use at higher risk to invest earlier-on with entrepreneurs to help them move new products into production. We are looking at a whole new venture corporation initiated with foundation funding, State funding, and hopefully Federal funding, as well.

For our own agency, we have even created a nonprofit subsidiary organization that handles all of our business development work. We determined that businesses have an easier time working with a private corporation than they do with a public sector agency because of confidentiality and other factors. We are able to be more entrepreneurial with that corporation and are looking at new ways of developing the dollars to help pay for the work that we do.

I would like to respond to your question about which are the best and worst Federal programs.

The best Federal programs that we work with are EDA, the Community Development Block Grant program the UDAG program—the UDAG program is great because it is a grant to a community to make a loan to a business which is then repaid to the community and they have that money revolving back that they can use for all kinds of investments. So it is an ongoing program. It is not a one-shot deal.

We see that with CDBG and EDA, as well And we package these programs all the time. It is not unusual, given the distressed nature of our area, for projects to be initiated with 8 to 10 different funding sources—State, Federal, local, private—all coming together to make it possible to do the deal in our area.

We would like to have a program like the ARC in the Midwest and it may be overdue. The Appalachian Regional Commission has been very helpful in the 13-State Appalachian area and that kind of program or priority, or emphasis in new dollars to deal with some of the competitive issues that we have in the upper Midwest might be something to take a look at right now.

We would not want to do that at the expense of our friends in the ARC area. We would like to see something like that for our own.

The worst Federal programs are EDA, Community Development Block Grant, UDAG, because of what has happened to them over the last several years. It has been unconscionable from our point of view to see those programs be cut back, and cut back, and cut back when they are the primary aid to business development in rural America, and we would like to see them supported.

Digital switching. If you do not have digital switching, what you probably have is electromagnetic switching. This is a layman's discussion. I am not a telecommunications engineer.

Senator BOSCHWITZ. That is good.

Mr. WARREN. That is the best I can do. You have electromagnetic switching. This is the mechanical throwing of magnetic switches, actually. So when you dial a number, there is mechanical switch-

es being thrown. Digital eliminates all of that and does it electronically.

Oftentimes you can tell whether you have digital switching if you have the capacity to direct dial. You know, if you have a credit card and you direct dial a long distance number. You get the tone, and then you dial in your credit card number. Sometimes you can then tell if you have a digital system.

But there is a device that is incorporated in many telephone companies that makes you think you have a digital system, but what it really does is it takes all those tones——

Senator BAUCUS. What is the advantage of a digital system?

Mr. MARTIN. Both the speed of the connection and the accuracy of the connection, which is especially important when you are transmitting data.

Senator BAUCUS. How much faster, roughly? Do you know?

Mr. MARTIN. Up to 2 minutes on a connection, which if you are sitting all day making long distance telephone calls at a telemarketing operation, is a very significant factor.

Senator BAUCUS. And also the accuracy of the transmission?

Mr. MARTIN. Right. If you are transmitting data, as opposed to voice communication, you do not lose that data.

Senator BAUCUS. I understand.

Mr. MARTIN. Omaha, Nebraska, is a major telecommunications telemarketing center.

Senator BAUCUS. How expensive is it to install, do you know?

Mr. MARTIN. This is a major problem in rural areas. I do not know the actual cost of installing one digital network, but what I do know is that the telecommunications companies can be very reluctant to make that kind of investment in areas where the phone usage is declining. What we are saying to the phone companies is, if you make that investment, then we can generate businesses that will generate the calls to justify the investment.

Senator BAUCUS. It is sort of a self-fulfilling prophesy.

Mr. MARTIN. Yes, it is. It is one of the difficult challenges.

Mr. STRINGHAM. I should note that one of the companies that Utah State University has started is built around a fiber optics switch that is being developed there as just a fluke that occurred in their labs, and it is one of the things that is drawing interest into the community. But telling that story was virtually impossible without establishing the center to do so.

Senator BAUCUS. I wonder if you, particularly Don and Mr. Martin, could just summarize briefly what is the one thing—the heart of the matter—that explains why, say Butte, has been able to turn around a desperate situation? Some communities do, some communities do not. Some of it has to do with the natural advantages that some communities have that other communities do not have. But in your situation, and in your experience, what explains why Butte, MT, or Minnesota, has been able to turn around a very depressing, very disastrous situation?

Mr. FRONTER. Well, I think mainly, Senator, the fact that we have been able to create what we refer to as that public/private partnership. However, developing that public/private partnership is not the easiest thing in the world to do.

I think the first thing you have to do is to develop a strategy for the community, and develop a plan, and carry that plan out. Then you have to use every tool you can find. I think we have done that, and we have done it successfully in Butte. I do not know of a Federal program of any magnitude that we have not used in Butte with the exception of UDAG, and we are trying. We are trying to get in under the wire with the UDAG grant before the program sees its final demise, which according to my information may be soon.

Senator BAUCUS. It also must require a great sense of cooperation, too, in the community. Is that correct?

Mr. PEOPLES. There has to be that public/private partnership working together. There were times in Butte when we did not work well together. To give you an example of what has happened in Butte, in early September of this year we had our annual economic planning strategy meeting for the community.

We had over 100 people who took the full day off work to come on a Tuesday and participate in that economic meeting.

Senator BAUCUS. You mean 100 people in the private sector?

Mr. PEOPLES. One hundred people, representing people from the president of the college to the president of the Montana Power Company, the labor leaders, to housewives, to students. We had a wide range of people that came to spend the day.

Senator BAUCUS. One full day?

Mr. PEOPLES. One full day, and it was well planned, well structured—but it is meaningful. We identify in that planning strategy not only the strategy, but who is going to be responsible in the community for the next year for carrying out that task.

We follow up on that on a quarterly basis by getting folks back together that are responsible for it. We have an Economic Development Coordinating Council. That consists of my office, the local development corporation, the Chamber of Commerce, the college, the Montana Power Company, you name it, anybody that is involved with economic development. We meet on a regular basis, and we make sure that that plan is developed and an annual strategy is carried out.

Senator BAUCUS. What sparked that sense of community, cooperation, or optimism? That has to be a precondition to a lot of this. Something has to spark that.

Mr. PEOPLES. I guess I could tell you I did it. [Laughter.]

But that would not be very fair. I think what happened is the fact that we had gone through so many problems, and we were getting desperate. I think we finally came to the realization in 1983 when Anaconda had suspended its operations that we had to do something. We have been working with economic development for much longer than since 1983 in Butte. We have been working at it back in the Model Cities program, and prior to that.

However, we were always doing it in a fragmented way. The local development corporation was doing one thing. The Chamber was doing something else. The City was doing something else. I think we finally came to the realization in 1983 when our unemployment rate reached 16.3 percent that we had better start doing something different, and doing it different meant coming together,

pushing away the barriers that existed, forgetting about whose turf you were standing on, and just working together as a community.

I think that has been the key to the thing. And frankly, the key to future success is going to depend on the continuation of that process of working together and not being worried about whose turf it is, or who is going to take responsibility for it, or whatever. It just has to be working together and using all the resources you can.

Frankly, I am one of those people who are very much opposed to any future cuts in any Federal programs, but perhaps one of the good things that came out of those cuts in Federal programs is the fact that we recognized that resources were diminishing, and we had better darn well use the resources that we had, and to use them as economically and as efficiently as we possibly could, and to do that as a community.

Senator BAUCUS. I appreciate that.

Mr. Martin, what is the heart of the matter? Explain northeastern Minnesota.

Mr. MARTIN. There are two things I often use to explain this. One is that I think wack-upside-the-head is one of the best motivational devices that there is. It sounds like Butte and Northeastern Minnesota got the same kind of whack, which eliminates a lot of——

Senator BAUCUS. That is pessimistic to hear, though.

Mr. MARTIN. Well, I think it is a reality, because one of the things that I have heard and I found to be true in my own life experiences, is that the best indicator of a business that is about to be in trouble is one that is doing well.

I know in our area in Northeastern Minnesota, 10 years ago we just completed $10 billion worth of new investment in the taconite industry. To talk to people at that point in time about diversifying our economic base and looking out for the future was impossible. But when we went through our economic depression in 1981 and 1982, everyone's attention shifted to economic development.

We went through a process over several years which included denial, hoping that it was going to come back, all that sort of thing that happens—and I have gone through this process with many communities. It is just like a death grieving process. But then there is coming out of that, and there is leadership that emerges.

If you can do what they have done in Butte and get a vision and some strategy and get people to understand what is going on in the world economy, not in an academic sense but just in a basic sense that these things are out of our control, decisions are being made out in Cleveland and Pittsburgh that are affecting our lives in which we have no say. They did not ask our opinion, there are transactions occurring in other countries that are impacting our life, so we need to take charge of what is going on here and just let them other things go as we really do not have that much to say about it in lowly Northeastern Minnesota.

But there are many things we can do, and we have some very talented people. By getting organized and by providing professional capacity and support we can get on with the hard work and make economic development a real work. It is not house pens or snake and mirrors. It is day to day grunt work done by

good grunts—and good economic development specialists are hard to get in our area. One of our biggest challenges is obtaining and retaining qualified economic development professionals. Once we train them, they can go to work in the Twin Cities for more money and less hassle. In our area it is never "what did you get for us yesterday," it is "what are you going to get for us tomorrow."

We need so many jobs that the pressure is always on. In the Twin Cities if you are successful once a year, that is fine. It is a nice life down there.

Senator BAUCUS. I appreciate the need for capital and financial help. How do you resolve that dilemma from our point of view as Federal officials? I guess you have been cut so much in the past maybe it is about time to try to provide further assistance.

Mr. MARTIN. I would say, as a minimum, we have taken our fair share so far.

Senator BAUCUS. That is right.

Mr. PEOPLES. I think that is important to recognize. The recent study that I saw on poverty indicates that poverty is increasing all over the country, not only in every region, north, east, southwest, whatever, but it is happening in all parts of society, rural society as well as urban, metropolitan suburban society. I think there is a direct correlation on what is happening in the cut in many of the Federal programs.

I like to look at these Federal programs as not so much programs but investments. I think EDA is an investment. It is an investment in economic development, CDBG, UDAG, job training, they are all investments in economic development, and they are investments in people. The correlation between the cuts in those programs and the rise in poverty leads me to believe that we have gone far enough. There has to be a better answer to solving the deficit problem rather than placing the burden on the backs of local governments throughout the country.

I think, Senator, there are a lot of things that obviously may sound simple in my way of thinking, but I would think that the Congress could respond very sufficiently to the Federal deficit by taking an entirely different look at it than cutting programs. Frankly, I think that it is time to stop, to put a freeze at least on Federal spending, to also forget that the tax cuts that are proposed in this coming year, and to start taking a look at all segments of the budget and recognize that we have to maintain an investment in people programs.

Senator BAUCUS. That is a good point. Frankly, national security involves not only military security but economic security, and our country is only going to be strong and project leadership around the world the more it is economically secure, which is in many ways more important than being militarily secure.

So it is a matter of budget priorities that I think should be shifted to make us more economically secure. Second, I think we as a country are going to have to encourage some of our allies, our western world trading partners to share a little more of the burden of military security as well as foreign aid, for example. France, Germany, Canada, and other countries are just going to have to help a little bit more.

They have been the direct beneficiaries of us for many years, and I think they are beginning to realize that it is time to help bear some of that responsibility. That will help us to devote more attention to our economic security.

Mr. STRINGHAM. Senator, before you close, may I make one specific suggestion? Last fall Congress passed an Act which legitimized the Federal lab consortium efforts and directed that small portions of every Federal research budget from all agencies be directed to underwrite that work. Basically all they are doing is removing the impediments to the flow of technology out of the Federal lab system.

The same kind of a bill would serve a marvelous purpose in the academic communities, if somehow a little pump priming money could be diverted to each institution, perhaps on a matching fund basis, to underwrite the cost maybe for two years at every institution to put in place an industrial interface program. In our experience, that is the greatest logjam. We have a marvelous scientific community, but we do not have the mechanisms to move those ideas out into business.

Senator BAUCUS. You have touched on another problem we have. I think Senator Cook mentioned it. That is, the rigidities in programs. A lot of these programs are awfully rigid—I think "self-exclusionary" was the term that was earlier used—one of the problems is we are such a big country. We are spread out all over this country of ours.

One advantage Japan has is being tightly contained. They talk to each other, and generally know where to move as a country and as a people because they see each other and talk to each other so much. But we are spread out. Somehow we have to deal with the givens and we will have to figure out a way to deal with them.

Okay, we appreciate it very much. The hearing is adjourned.

[Whereupon, at 12:32 p.m., the hearing was adjourned.]

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